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APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. ~~1082~~

70-52

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI FILED DECEMBER 10, 1970
CERTIORARI GRANTED FEBRUARY 22, 1971

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1082

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT

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No. 1213-Civil DOCKET

Title of Case	Attorneys
MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF vs. UNITED STATES OF AMERICA, DEFENDANT. CONSOLIDATED WITH CIVIL ACTION No. 1214 PER ORDER FILED 4-8-68	For Plaintiff: John C. Satterfield P.O. Box 466 Yazoo City, Miss. 39194 For Defendant: Robert E. Hauberg P.O. Box 2091 Jackson, Miss. 39205

Basis of Action: Claim for Income Tax Refund

12-15-67 J. S. 5

Date	Plaintiff's Account	Received	Disbursed
12-15-67	Satterfield	15.00	
-29-67	U.S. Treas. CD16-5		15.00

Abstract of costs, To Whom Due, U.S. Clerk. Amount \$15.00.

Date	Filings-Proceedings
12-15-67	COMPLAINT with four copies with Exhibits A through F—filed.
12-15-67	SUMMONS issued and forwarded to U.S. Marshal with four copies and four copies of complaint and exhibits A through F attached for service on U.S. Attorney and Attorney General.
2- 9-68	Copy of Rule as to Non-Resident attorney mailed to John Satterfield.
2-19-68	Answer of Defendant, United States of America, with Certificate of service thereon—filed.
2-28-68	Marshal's return of service on summons executed on the United States of America December 19, 1967 by mailing a copy of the Summons and Complaint to Ramsey Clark, Attorney General, USA, Department of Justice, Washington, D.C. (Registry Receipt attached to return)—and Executed at Jackson, Miss. on December 19, 1967 by delivering a copy of the summons and complaint to Joseph E. Brown, Assistant U.S. Attorney—filed.

Date	Filings-Proceedings
4- 4-68	Plaintiff's Motion to Consolidate Civil Action Nos. 1213 and 1214, with Certificate of Service, filed.
4- 8-68	ORDER: consolidating Civil Action Nos. 1213 and 1214 for hearing and otherwise (with the exception that separate judgments shall be entered in each proceeding) and shall be considered together upon the docket of this Court as if both had been assigned upon the docket Civil Action No. 1213, filed and entered O.B. 1968, Page 91. (Copies mailed attorneys)
5-14-68	DEPOSITION of Walter C. Varlander, Jr., President, New Orleans Bank for Cooperatives, taken by Defendant on April 19, 1968, filed.
11- 6-68	Stipulation as to facts and documents with copies of exhibits 30-A through 32 attached, filed.
11- 5-68	Marshal's return executed on subpoena as to A. E. Beall, filed.
11-11-68	EXHIBITS: P-1 through P-5; D-1 through D-6, filed.
1-17-69	Court Reporter's transcript of hearing before Hon. Harold Cox on November 7, 1968, filed.
[iii] 2-14-69	Finding of Facts and Conclusions of Law . . . "A separate judgment accordingly may be presented for entry in accordance with this opinion in each of these cases.", filed.
2-14-69	Copy of above mailed to attorneys Hauberg and Satterfield.
2-18-69	At direction of Judge Cox, 1st page of above Opinion substituted.
3-24-69	Copy of above Judgment mailed to attorneys of record.
3-24-69	JUDGMENT: Ordered, adjudged and decreed that plaintiff, Mississippi Chemical Corp., a corp., do have and recover of and from the defendant, the United States of America, the principal sum of \$85,298.51, together with interest thereon at the rate of six per cent per annum as follows: From April 4, 1966, upon the sum of \$33,859.37, from June 29, 1967, upon the sum of \$20,006.11, and from July 21, 1967, upon the sum of \$31,433.03, all interest being payable until this judgment is paid, filed and entered O.B. 1969, Page 42.
3-24-69	Final JS-6 Card, filed.
5-21-69	Defendant's Notice of Appeal to the U.S. Court of Appeals for the Fifth Circuit from Judgment entered herein on March 24, 1968, with Certificate of Service, filed.
5-22-69	Certified copy of above Notice of Appeal mailed to Clerk of Fifth Circuit.
6-23-69	Order extending time for filing the record upon appeal fifty (50) days or a total of ninety (90) days from the date of filing of the first Notice of Appeal, filed and entered O.B. 1969, Page 131. (Copy mailed to Fifth Circuit.)

[iv] A true copy, I hereby certify.

ROBERT C. THOMAS,

Clerk.

(SEAL)

By /s/ B. PRICE,
Deputy Clerk.

Dated:

No. 1214-Civil DOCKET

Title of Case	Attorneys
COASTAL CHEMICAL CORPORATION, PLAINTIFF vs. UNITED STATES OF AMERICA, DEFENDENT CONSOLIDATED WITH CIVIL ACTION NO. 1213 PER ORDER FILED 4-8-68	For Plaintiff: John C. Satterfield P.O. Box 466 Yazoo City, Miss. 39194 For Defendant: Robert E. Hauberg P.O. Box 2091 Jackson, Miss. 39205

Basis of action: Claim for Income Tax Refund

12-15-67 J. S. 5

Date	Plaintiff's account	Received	Disbursed
12-15-67	Satterfield	15.00	
-29-67	U.S. Treas. CD 16-5		15.00

Abstract of Costs To Whom Due U.S. Clerk, Amount 15.00.

Date	Filings-Proceedings
12-15-67	COMPLAINT original and four copies—with Exhibits A through F attached—filed.
12-15-67	SUMMONS issued and forwarded to U.S. Marshal with Four copies Summons—complaint and exhibits attached—for service on U.S. Attorney and Attorney General.
[v] 2-19-68	Answer of Defendant, United States of America, with Certificate of Service—filed.
3-1-68	Marshal's return on summons, executed, filed.
4-4-68	Plaintiff's Motion to Consolidate Civil Action Nos. 1213 and 1214, with Certificate of Service, filed.
4-8-68	ORDER: consolidating Civil Action Nos. 1213 and 1214 for hearing and otherwise (with the exception that separate judgments shall be entered in each proceeding) and shall be considered together upon the docket of this Court as if both had been assigned upon the docket Civil Action No. 1213, filed and entered OB, 1968, Page 91. (Copies mailed attorneys)

Date	Filings-Proceedings
5-14-68	DEPOSITION of Walter C. Verlander, Jr., President, New Orleans Bank for Cooperatives, taken by Defendant on April 10, 1968, filed in Civil Action No. 1213.
11- 6-68	Stipulation as to Facts and Documents with Exhibits (In Box) attached, filed.
11-11-68	EXHIBITS: P-1 through P-5; D-1 through D-6, filed.
1-17-69	Court Reporter's transcript of hearing before Hon. Harold Cox on November 7, 1968, filed. (Transcript placed in Civil Action No. 1213.)
2-14-69	Finding of Facts and Conclusions of Law : "A separate judgment accordingly may be presented for entry in accordance with this opinion in each of these cases," filed.
2-14-69	Copy of above mailed to attorneys Hauberg and Satterfield.
[vi] 2-18-69	At direction of Judge Cox, 1st page of above Opinion substituted.
3-24-69	JUDGMENT: Ordered and adjudged that plaintiff, Coastal Chemical Corp. recover from defendant, U.S.A., the sum of \$265,044.35, plus interest thereon as provided by law; no costs be assessed herein, filed and entered. O.B. 1969, Page 41. (Copy mailed attorneys of record.)
3-24-69	Final JS-6 Card. filed.
5-21-69	Defendant's Notice of Appeal to the U.S. Court of Appeals for the Fifth Circuit from Judgment entered herein on March 24, 1969, with Certificate of Service, filed.
5-22-69	Certified copy of above Notice of Appeal mailed to Clerk of the Fifth Circuit.
6-23-69	Order: extending time for filing record on appeal to 90 days from date of filing first notice of appeal—filed and entered O.B. 1969, Page 126.
6-23-69	Copy of above order forwarded to Fifth Circuit Court of Appeals.

A true copy, I hereby certify.

ROBERT C. THOMAS
Clerk.

By: /s/ B. PRICE,
Deputy Clerk.

(SEAL)

In the United States District Court for the Southern Judicial
District of Mississippi, Western Division

Civil Action No. 1213

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

vs.

THE UNITED STATES OF AMERICA, DEFENDANT

COMPLAINT

(Filed Dec. 15, 1967)

COUNT I

COMES Mississippi Chemical Corporation, a corporation organized under the laws of the State of Mississippi, and files this suit against The United States of America and for cause of action says:

I.

Plaintiff is a corporation organized under the laws of the State of Mississippi with its domicile and principal place of business in Yazoo City, Mississippi, in the Southern District of Mississippi, Western Division, of the United States District Court.

II.

Defendant is The United States of America upon whom service of process may be had by service of summons upon the United States District Attorney of Jackson, Mississippi, and by sending a copy of the summons and complaint to the Attorney General of the United States at Washington, D.C.

III.

This is an action of a civil nature for the recovery of United States income taxes and interest paid thereon, which income taxes and interest were erroneously or illegally assessed and wrongfully collected.

IV.

Plaintiff is organized under the General Corporate Laws of the State of Mississippi but is a cooperative qualified to receive financing under the Statutes of the United States of America as a cooperative. It is and since the beginning of its operation has been engaged in manufacturing fertilizer and distributing same primarily to its stockholder-patrons.

V.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1961, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$18,464.09 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$18,464.09 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1961, the sum of \$28,630.64 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 11341(b) of Title 12, United States Code.

VI.

The Farm Credit Act of 1955 (Section 1134d (a)(3) of Title 12, USC) requires a borrower from a Bank of Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a pay-

ment of fifteen per cent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1961, plaintiff paid the New Orleans Bank for Cooperatives \$18,464.09 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d (a)(3) of Title 12, United States Code. Plaintiff would show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1961, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said Bank for said payment had no market value for the reasons hereinafter set forth.

VII.

Section 1134 1(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1961, plaintiff borrowed money from the New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as patronage dividends in the stated amount of \$28,630.64. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$28,630.64 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30, 1961.

VIII.

(a) That the amount paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal year ending June 30, 1961, for the privilege of borrowing from said Bank is a proper deductible expense either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives

was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as a patronage dividend for the fiscal year ending June 30, 1961, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

IX.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1961, plaintiff paid additional income taxes of \$24,489.26 plus applicable interest of \$7,728.69 thereon for its fiscal year ending June 30, 1961. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$24,489.26 was erroneous.

X.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1961, said Claim being for a refund of income taxes erroneously assessed and paid in the amount of \$24,489.26, plus applicable interest of \$7,728.69. Said Claim for Refund (including all Exhibits attached thereto) is attached hereto as Exhibit A and made a part hereof as if copied herein.

XI.

That by Certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending

June 30, 1961 had been denied. There is attached hereto as Exhibit B letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1961.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$24,489.26 and applicable interest paid of \$7,728.69 and interest thereon as allowed by law; and for costs of this action, and for such other and further relief as to the Court may seem just and proper.

COUNT II

I.

Plaintiff re-alleges and re-avers each and every allegation of paragraphs I through IV of Count I above.

II.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1962, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$16,421.75 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$16,421.75 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1962, the sum of \$27,489.40 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 11341(b) of Title 12, United States Code.

III.

The Farm Credit Act of 1955 (Section 1134d (a)(3) of Title 12, USC) requires a borrower from a Bank of Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a payment of fifteen percent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1962, plaintiff paid the New Orleans Bank for Cooperatives \$16,421.75 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d (a)(3) of Title 12, United States Code. Plaintiff would show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1962, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said Bank for said payment had no market value for the reasons hereinafter set forth.

IV.

Section 1134 1(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1962, plaintiff borrowed money from the New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as patronage dividends in the stated amount of \$27,489.40. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$27,489.40 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30, 1962.

V.

(a) That the amount paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal year ending June 30, 1962, for the privilege of borrowing from said Bank is a proper deductible expense either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as a patronage dividend for the fiscal year ending June 30, 1962, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

VI.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1962, plaintiff paid additional income taxes of \$22,798.79 plus applicable interest of \$5,504.76 thereon for its fiscal year ending June 30, 1962. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$22,798.79 was erroneous.

VII.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1962, said Claim being for

a refund of income taxes erroneously assessed and paid in the amount of \$22,798.79 plus applicable interest of \$5,504.76. Said Claim for Refund for fiscal year ending June 30, 1962, (including all Exhibits attached thereto), is attached hereto as Exhibit C and made a part hereof as if copied herein.

VIII.

That by Certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending June 30, 1962, had been denied. There is attached hereto as Exhibit D letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1962.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$22,798.79 and applicable interest paid of \$5,504.76 and interest thereon as allowed by law; and for costs of this action, and for such other and further relief as to the Court may seem just and proper.

COUNT III

I.

Plaintiff re-alleges and re-avers each and every allegation of paragraphs I through IV of Count I above.

II.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1963, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$18,863.35 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$18,863.35 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1963, the sum of \$25,152.83 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 1134 1(b) of Title 12, United States Code.

III.

The Farm Credit Act of 1955 (Section 1134d (a)(3) of Title 12, USC), requires a borrower from a Bank of Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a payment of fifteen per cent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1963, plaintiff paid the New Orleans Bank for Cooperatives \$18,863.35 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d (a)(3) of Title 12, United States Code. Plaintiff would show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1963, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said Bank for said payment had no market value for the reasons hereinafter set forth.

IV.

Section 1134 1(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1963, plaintiff borrowed money from the New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as

patronage dividends in the stated amount of \$25,152.83. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$25,152.83 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30, 1963.

V.

(a) That the amount paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal year ending June 30, 1963, for the privilege of borrowing from said Bank is a proper deductible expense either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as a patronage dividend for the fiscal year ending June 30, 1963, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

VI.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1963, plaintiff

paid additional income taxes of \$21,113.87 plus applicable interest of \$3,664.14 thereon for its fiscal year ending June 30, 1963. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$21,113.87 was erroneous.

VII.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1963, said Claim being for a refund of income taxes erroneously assessed and paid in the amount of \$21,113.87 plus applicable interest of \$3,664.14. Said Claim for Refund for fiscal year ending June 30, 1963, (including all Exhibits attached thereto), is attached hereto as Exhibit E and made a part hereof as if copied herein.

VIII.

That by certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending June 30, 1963, had been denied. There is attached hereto as Exhibit F letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1963.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$21,113.87 and applicable interest paid of \$3,664.14 and interest thereon as allowed by law; and for costs of this action, and for such other and further relief as to the Court may seem just and proper.

/s/ John C. Satterfield

JOHN C. SATTERFIELD

Attorney for Mississippi Chemical Corporation,

P.O. Box 466, Masonic Building,

Yazoo City, Mississippi.

Of Counsel:

J. Dudley Buford

P. O. Box 1172

Jackson, Mississippi.

Hollaman M. Raney

P. O. Box 388

Yazoo City, Mississippi.

ATTACHMENT TO AND MADE A PART OF CLAIM: (FORM 843)
 Filed by: Mississippi Chemical Corporation, P.O. Box 388,
 Yazoo City, Mississippi

For the fiscal year ended June 30, 1961

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(d) *Interest* \$18,464.09

The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100 par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to 15 per cent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the above amount.

Cost incurred in purchasing class C stock are not deductible. See Rev. Rul. 65-241.

(e) *Patronage Dividend on "C" stock* \$28,630.64

The taxpayer received class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The amount was not included in income as having no value.

The Bank, in its notification of patronage refund to its shareholders, recommends that the amount be reflected at face value and a credit to operating income.

The "C" stock is assigned as collateral against loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount—the same as any other collateral having face value. The amount above, is therefore includable in income under section 61 of the 1954 Code.

The income tax related to (d) above amounted to \$9,601.33 and was paid as shown by attached copy of letter accompanying the remittance.

The income tax related to (e), amounting to \$14,87.93, was agreed to in Form 870 which was sent to Mr. Julian W. Johnson, Appellate Conferee, Internal Revenue Service, U.S. Treasury Department, 711-2121 Building, 2121—8th Avenue, North, Bir-

mingham, Alabama 35203. The above amount of income tax was paid June 29, 1967 as part of a check for \$20,006.11, which included applicable interest.

It was understood with Mr. Johnson that the execution and filing of the foregoing Form 870 would not preclude the filing of a Claim (Form 843). In fact it was understood that a claim would be filed as a basis of litigation in the applicable U.S. District Court.

The total income tax represented by (d) and (e) above amounts to \$24,489.26 shown as (g) on Form 843.

It is claimant's position that the interest represented by (d) was deductible and further that the class C stock referred to was not worth \$100.00 per share during the fiscal year ended June 30, 1961.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1962 and 1963.

MISSISSIPPI CHEMICAL CORPORATION,
Post Office Box 388, Yazoo City, Mississippi 39194,
April 4, 1966.

Mr. J. G. MARTIN, Jr., District Director,
Internal Revenue Service, U.S. Treasury Department,
301 North Lamar Street, Jackson, Mississippi 39202.

Re Your File Form L-191B-430:VBH:mnm, Mississippi
Chemical Corporation, Yazoo City, Mississippi.

DEAR SIR: We have examined copy of an examination report explaining proposed adjustments to the tax liability of Mississippi Chemical Corporation, letter of transmittal being dated March 14, 1966. This includes the items hereinafter described representing the amounts paid by the taxpayer as one of the requirements to enable it to obtain loans from the New Orleans Bank for Cooperatives for which said Bank has agreed to issue Class C stock at par value of \$100 per share. In each of the years stated the taxpayer deducted the amount involved as interest upon or cost of acquisition of such loans, such stock

being without market value. Deficiencies are proposed based upon the disallowance of such items under Rev. Rul. 65-241.

Because of the existence of such ruling we are not including these items in the protest we are filing in behalf of the taxpayer requesting a hearing as to the items other than those here listed and the items included in "Computation of Income Tax for Partial Agreement", as to which you are handed a check today. Such items are as follows:

Fiscal year ending 6/30/61—page 7 (explanation page 9) "Interest"
\$18,464.09
Fiscal year ending 6/30/62—page 13 (explanation page 15) "Interest"
\$16,421.75
Fiscal year ending 6/30/63—page 20 (explanation page 22) "Interest"
\$18,803.35

We have computed the additional tax and interest arising from such items as follows:

Fiscal year 6/30/61	
Tax -----	\$9,601.33
Interest -----	2,610.51
Fiscal year 6/30/62	
Tax -----	8,539.31
Interest -----	1,809.40
Fiscal year 6/30/63	
Tax -----	9,808.93
Interest -----	1,489.89
Total -----	\$33,859.37

In accordance with our discussion with Mr. Broom, we are enclosing check of the Mississippi Chemical Corporation in the sum of \$33,859.37 and will expect to file claim for refund in that amount within the next few days.

Yours very truly,

MISSISSIPPI CHEMICAL CORPORATION,
By, JOHN C. SATTERFIELD, *General Counsel.*

JCS:md
Enclose, Check

STATEMENT CONCERNING PATRONAGE REFUNDS RECEIVED FROM THE NEW ORLEANS BANK FOR COOPERATIVES IN THE FORM OF CLASS "C" STOCK OF SUCH BANK

You are handed herewith the following items which are made a part of this statement by reference:

1. Letter from Mississippi Chemical Corporation and Coastal Chemical Corporation to the Examining Agent, Mr. John J. Koch, dated November 1, 1965.

2. Letter of Honorable D. R. Stump, Vice President of the New Orleans Bank for Cooperatives, dated March 22, 1966, including "Statement of Policy of New Orleans Bank for Cooperatives on Retirement of Government Capital" adopted June 20, 1959 and reapproved February 25, 1966; and statement by years of the amount of Class "C" stock issued by the New Orleans Bank for Cooperatives.

3. Letter from N. F. Pendleton, President of the New Orleans Bank for Cooperatives (now deceased), dated December 22, 1965, with eight attachments.

The facts which may be material are delineated by Regulation Sec. 1.61-5 implementing TIR No. 69, effective December 3, 1959. It provides that non-cash patronage refunds are includable in the gross income of patrons to the extent of the fair market value of the document notifying the patron of the amount of the allocation made to him at the time of its receipt by the patron. The provision particularly in point is as follows:

Any document which is payable only at the discretion of the cooperative association or which is otherwise subject to the conditions beyond the control of the patron shall be considered not to have any fair market value at the time of its receipt by the patron, unless it is clearly established to the contrary.

The enclosures demonstrate conclusively that the Class "C" stock of NOBC is payable only at the discretion of that cooperative association and also is otherwise subject to conditions beyond the control of the patron. No facts here "clearly establish to the contrary", i.e., that such stock had any market value or, particularly, that its market value was the full amount of the par value thereof. The proposed adjustment is in the full amount of the par value of such patronage refunds.

As detailed in our letter of November 1, 1965, the law prohibits the payment of dividends on Class "C" stock and, of course, no interest is payable thereon. It is in effect non-voting stock in the hands of the corporation after such corporation has acquired one share thereof. The Bank was established under the statute on the basis of "one member one vote" regardless of the amount of stock which the member may thereafter receive as patronage refunds or otherwise.

The change in the action by the NOBC concerning the payment of Class "A" stock owned by the government which occurred after December 22, 1965, when Mr. Pendleton wrote his letter, and before March 22, 1966, when Mr. Stump wrote his letter, conclusively establishes that the "document . . . is payable only at the discretion of the cooperative association". No payment of Class "C" stock on a revolving fund basis can begin until all Class "A" stock is paid in full, as well as outstanding Class "B" stock of the year affected. On December 22, 1965, the Board of Directors of the NOBC expected to issue debentures obtaining sufficient funds to acquire all outstanding Class "A" stock on June 30, 1966. On February 25, 1966, the Board of Directors reconsidered such action, deferred any such payment "until such time as the officers of the Bank determine it will be advantageous to the Bank and its borrowers for the Board to reconsider this subject", and readopted the original schedule attached to the letter of Mr. Stump, under which all Class "A" stock would be retired in 1976. The actual experience through 1965 shown in the attachment indicates that such retirement could be completed under the schedule in 1975. Hence, the commencement of retirement of any Class "C" stock has been deferred for an additional nine years, through the exercise of the discretion of the cooperative association involved, i.e., the New Orleans Bank for Cooperatives.

Subject to the "conditions beyond control of the patron" which are mentioned below, if the revolving retirement of the NOBC Class "C" stock begins in 1975, and if the earnings of the cooperative bank continue to be comparable to those of recent years, it appears that the revolving basis of payment may be sought to be accomplished within ten or fifteen years from the date of the beginning of such process. Hence, optimistically, it appears that the Class "C" stock received by the taxpayer during the fiscal year ending June 30, 1961, may be paid between 1980 and 1985; such stock received for the fiscal year ending June 30, 1962, may be paid between 1981 and 1986; such stock received for the fiscal year ending June 30, 1963, may be paid between 1982 and 1987.

The question here should be determined "at the time of its receipt by the patron". At such time the stock was and it still is "payable only at the discretion of the cooperative association"; it now appears that such payment may occur some

twenty years after its receipt, subject to the uncertainties mentioned below; with no interest or dividends payable on the stock, we cannot see how the same can be considered to have market value. If it had any market value, the same would be nominal.

In addition to the legally established fact that this stock is payable only at the discretion of the cooperative association, the same is likewise "subject to the conditions beyond the control of the patron". This includes the following:

1. The amount of future earnings of the Bank.
2. The state of the law and regulations relating to banks for cooperatives in the years succeeding 1980. If, for example, the law were amended to require the payment of all current earnings in cash (as is now advocated by some parties), no Class "C" stock could be retired.

3. The discretion of the Board of Directors of the cooperative association, i.e., the Bank. The change that occurred in early 1966 is a complete and perfect illustration thereof. Many factors affect the earnings of the cooperative bank. For instance, it has attempted to maintain a "spread" between the cost of money borrowed by it and the rate of interest paid to it of at least 100 points. Several years ago it was maintaining a spread of from 150 points to 170 points. Recently this has dropped to a range of between 70 points and 100 points, and the last debentures of the Bank were sold at an interest rate of 5.4 percent while it is lending money at an interest rate of 5.5 percent, only a 10-point spread. It will be necessary for the Bank to take action to assure itself of a proper spread and its effect upon the business of the Bank is necessarily unknown.

In our letter of November 1, 1965, a copy of which is attached hereto, we went into more detail concerning the facts affecting the fair market value at the time of receipt by the patron of the right to receive Class "C" stock of NOBC.

With reference to the statement in the examination report that Mississippi Chemical Corporation and Coastal Chemical Corporation are the only cooperatives entering Class "C" stock received as patronage refunds as having no market value, we call attention to the letter dated December 22, 1965, signed by the President of the New Orleans Bank for Cooperatives, stating, "We do know specifically of one other cooperative in this district, other than yourselves, which writes the stock off for tax

purposes and, according to information given to us, there are cooperatives in other districts which do likewise." In fact, we have found that there are numerous cooperatives throughout the country which follow the same procedure employed by the taxpayers here in dealing with Class "C" stock of the numerous banks for cooperatives throughout the country.

In this connection, it should be noted as discussed in the letter from Mr. Pendleton that most of the cooperatives receiving such patronage refunds seem to be exempt cooperatives under Section 521, and hence the entry of such stock at face value or any other value would not affect their income tax. It is also stated by Mr. Pendleton in said letter with reference to "exempt cooperatives" and non-exempt cooperatives that, "In either case, if the cooperative sets the stock up at face value, the corresponding income would normally be credited to pool earnings but also deducted by the cooperative as a patronage refund except for the nonmember portion, in the case of non-exempt cooperatives."

However, the action of other cooperatives is immaterial. The regulations apply specifically to this type of stock patronage refund as outlined above.

II.

STATEMENT CONCERNING CLASS "C" STOCK IN THE NEW ORLEANS BANK FOR COOPERATIVES PURCHASED AS AN "INTEREST OVERRIDE" AS A CONDITION PRECEDENT TO OBTAINING AND MAINTAINING LOANS FROM SUCH BANK

The Farm Credit Act of 1955 revised the capital structure of the twelve Banks for Cooperatives and the Central Bank for Cooperatives by providing for three classes of stock. See 12 USCA Sec. 1134d. Class "A" stock is government capital and is held by the Governor of the Farm Credit Administration on behalf of the United States. Class "A" stock was issued in exchange for stock held in the Banks for Cooperatives by the Governor on the effective date of the Farm Credit Act of 1955.

Class "B" stock is investment stock and provision is made for the payment of dividends not to exceed 4 per cent per annum. It is non-voting stock and it is owned principally by cooperative associations.

Class "C" stock is issued to farmer-cooperatives which borrow from the Banks for Cooperatives. A farmer-cooperative

Acquires Class "C" stock in two ways in doing business with a Bank for Cooperatives:

- (1) As a patronage dividend. 12 USCA Sec. 1134e(b).
- (2) Required purchase as a condition to a loan. 12 USCA Sec. 1134d(a)(3).

So long as a Bank for Cooperatives has Class "A" stock outstanding, all earnings (after the payment of a franchise tax, setting aside of required reserves and dividends on Class "B" stock) must be allocated to patron-cooperatives as patronage dividends in the form of Class "C" stock. 12 USCA Sec. 1134e (a). When all government capital (Class "A" stock) in a Bank for Cooperatives has been retired, it loses its exemption from income taxes. See 12 USCA Sec. 1138c.

In 1964 Congress passed P. L. 88-528, which amended the law pertaining to patronage dividends of Banks for Cooperatives to provide that for any fiscal year that a Bank for Cooperatives is subject to Federal income taxes, it shall pay in money rather than Class "C" stock such portion of its taxable income as is necessary to permit it to issue qualified written notices of allocation for the balance. See 12 USCA Sec. 1134e (b).

The Farm Credit Act of 1955 also requires a borrower from a Bank for Cooperatives to invest quarterly in Class "C" stock in an amount equal to not less than 10 percent nor more than 25 percent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has prescribed 15 percent. Payments for such "C" stock are made quarterly or when the regular interest payments of the borrower are made. See 12 USCA Sec. 1134d(a)(3). It is this required purchase of Class "C" stock that is involved here.

It is important to note that the purpose of issuing Class "C" stock in both cases is identical—retirement of Class "A" stock. For every dollar of Class "C" stock issued either by way of patronage dividend or by way of required purchase, a dollar of Class "A" stock is retired. 12 USCA Sec. 1134d(a)(1). The concept of Class "C" stock was created by the Farm Credit Act of 1955 for the sole and express purpose of retiring government capital.

For the reasons outlined herein, we believe that the required purchase of such Class "C" stock should not be capitalized as an

asset but should be charged off as an expense for both book and tax purposes. In part, this view stems from what we believe to be the proper treatment for the receipt of Class "C" stock as patronage dividends.

The Internal Revenue Service issued Technical Information Release No. 69 on February 14, 1958, in which it announced that it would conform with the principles enunciated by court decisions in connection with the tax treatment of allocations of patronage dividends by cooperative associations to its patrons. The cases referred to were the *Long Poultry Farms* case (249 F.2d 726) decided in 1957 and the *Carpenter* case (219 F.2d 635) decided in 1955. These cases had held that a patron was required to report non-cash patronage dividends received from cooperative associations as income only to the extent that such non-cash patronage refunds had fair market value. Where such patronage refunds had no fair market value, the patron was not required to include them in his gross income in the year the notice of the non-cash refund was received.

Regulation Sec. 1.61-5 implementing TIR No. 69 became effective December 3, 1959. It provides that non-cash patronage refunds are includable in the gross income of patrons to the extent of the fair market value of the document notifying the patron of the amount of the allocation made to him at the time of its receipt by the patron. Any document which is payable only at the discretion of the cooperative association or which is otherwise subject to the conditions beyond the control of the patron shall be considered not to have any fair market value at the time of its receipt by the patron, unless it is clearly established to the contrary.

Required Purchase of Class "C" Stock is Deductible: The reasons for our position that the required purchase of Class "C" stock is a deductible expense are that such amount is either—

(1) An additional *interest* expense under Sec. 163 of the Internal Revenue Code, or

(2) An *ordinary loss* under Sec. 165 of the Internal Revenue Code.

Required purchase of Class "C" stock is deductible as an interest expense: Sec. 163, IRC provides as follows: "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The courts have said that the

term "interest" is the amount which one has contracted to pay for the use of borrowed money. Where a borrower is required to pay something in addition to what is denominated as "interest", in order to obtain the loan, the additional payment may also be deducted as an interest expense. See *Wiggin Terminals, Inc. v. U.S.* (1st Cir. 1929) 36 F.2d 893; *Court Holding Company*, 2 TC 531 affd. 324 U.S. 331 (1945); *L. R. Heating Co.*, 28 TC 894.

Loan agreements with the New Orleans Bank for Cooperatives required Mississippi Chemical Corporation and Coastal Chemical Corporation to pay the interest charges specified plus an additional payment equal to 15 per cent of the total interest paid each quarter. This 15 per cent interest override paid during the years in question in the form of required purchase of Class "C" stock was required as a condition of the loan, the same as a basic interest charge. When this 15 per cent interest override is added to the basic rate charged by the New Orleans Bank for Cooperatives, the total combined rate is still reasonable and typical for a total interest charge. In order to prove that this total payment is deductible as *interest*, we have demonstrated that Class "C" stock is not really "stock" in the normal sense of the word.

We content that Class "C" stock is not actually stock for either accounting or tax purposes. What it is, is a euphemistic term for an additional interest charge imposed by the Bank for Cooperatives for the use of money. What are the normal attributes of stock? Stock will normally have one or more of the following characteristics:

- (1) A right to dividends.
- (2) One or more votes per share.
- (3) A stock certificate to evidence its issue.
- (4) Possibility of appreciation in value.
- (5) Transferability.
- (6) Market value.
- (7) Collateral value.

See letter of November 1, 1965, to the Examining Agent, Mr. Koch, for a full discussion of each of the above items.

A fundamental rule in Federal Income Tax law is that the substance of a transaction rather than mere form controls tax liability. This rule is most frequently asserted by the government against the position taken by the taxpayer, often with

great success. Certainly the rule should be equally applicable when applied by the taxpayer against the contention of the government.

Cases are legion where something called stock by the taxpayer is held to be something else, such as a bond or note, for the purpose of federal income taxation. These cases make it quite clear that the name by which an instrument is called may be relatively unimportant for tax purposes. What is important are the characteristics of the instrument in question. An instrument may be stock within the meaning of State Corporation Law, yet it may be considered as a debt instrument for the purpose of income taxes. As noted above, when the characteristics of Class "C" stock are carefully analyzed, it becomes evident that while the law relating to Banks for Cooperatives calls this instrument "stock", it is clearly not stock within the meaning of Federal Income Tax law.

Required purchases should be treated consistent with patronage dividends: The record shows that Class "C" stock is likewise issued as a patronage dividend. Under Reg. Sec. 1.61-5 non-cash dividends received from a cooperative are includable only to the extent of fair market value, and this is presumed to be lacking where redemption rests in the discretion of a board of directors. We believe that it is not open to serious question that Class "C" stock received as a patronage dividend should not be taken into income because of its lack of fair market value. Incidentally, we see no reason for doubting that Reg. Sec. 1.61-5 and the Sections 1381 through 1388, IRC (Subchapter T) pertaining to cooperatives and their patrons applies to the Banks for Cooperatives and their patrons. Reg. Sec. 1.1381-1 provides that Subchapter T applies "to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons." Reg. Sec. 1.1388-1(e) defines the term "patron" to include cooperative associations. Reg. Sec. 1.65-1 contains no definitions, but we believe the above definitions are clearly applicable.

This being the case, it certainly is not logical to conclude that Class "C" stock which is *purchased* is somehow different, and should be set up as an asset at full face value. If "C" stock has *no value* when received as a patronage dividend, it seems incontrovertible that it likewise has *no value* when purchased. In both cases it is exactly the same thing, and is issued for exactly

the same purposes. Bank officials tell us that it is treated the same on the books of the Bank.

Required purchase of Class "C" stock is quite different from other Federal Agency stock purchases: The next feature that should be noted is that the amount of the required purchase of Class "C" stock is tied directly to the amount of interest paid. During the years involved, the amount of required purchase established by the New Orleans Bank for Cooperatives was 15 per cent. In any event, this is different from the required purchase of stock in the Federal National Mortgage Association and Production Credit Associations, which also require certain stock purchases as a condition to doing business.

In the case of the Federal National Mortgage Association ("Fannie Mae") the law requires that when a mortgage is sold to Fannie Mae, the seller must purchase stock in Fannie Mae in an amount equal to 3 per cent of the mortgage sold. However, Fannie Mae stock has a market value and may be and is frequently sold. This is in contrast to Class "C" stock in a Bank for Cooperatives, which has no market value and in which there are no known instances of its ever having been sold to another purchaser.

Likewise in the case of PCA, the borrower is required to have invested in Class "B" stock an amount equal to 5 per cent of the principal borrowed, but this Class "B" stock has a very definite market value and as a matter of practice we understand that PCA's repurchase that stock at cost when a loan is retired. Again this is in sharp contrast to Class "C" stock in a Bank for Cooperatives, which has no economic value but is merely imposed by way of additional interest cost.

It is significant to note that in the case of both the required purchase of Fannie Mae stock and PCA stock, the amount of stock required to be purchased is based on principal and thus it needs to be purchased only once. Class "C" stock purchased in a Bank for Cooperatives is based on interest paid by the borrower and it is thus in the nature of an additional and recurring item of expense. This distinction is very important.

Provisions on guaranty fund equivalents indicates that true stock is not involved: Another reason for concluding that Class "C" stock is not really stock is the fact that the law creating the Banks for Cooperatives provides that where a cooperative association is not authorized under the laws of the state in which

it is organized to hold stock in a Bank for Cooperatives, the Bank shall, in lieu thereof require the association to pay into or have on deposit in a guaranty fund of the Bank a sum equal to the amount of the Class "C" stock which the association would otherwise be required to purchase. See 12 USCA Sec. 1134d(b). It is interesting to note that the holder of guaranty fund equivalents of Class "C" stock have the same rights and status as a holder of Class "C" stock and that the rights and obligations of the Bank as respects such guaranty fund equivalent are identical to the rights and obligations as respects Class "C" stock. This further tends to support the view that Class "C" stock is in reality not stock but merely an additional payment which must be made to the Bank for Cooperatives in order that it might have a greater net income, which in turn might be used to retire government capital.

Tax treatment on redemption of Class "C" stock: The statute provides that on retirement of Class "C" stock: "After retirement of all Class 'A' stock, Class 'C' stock also may be retired at par by calling the oldest outstanding Class 'C' stock, but Class 'C' stock that was issued for a fiscal year period shall not be called for retirement until all Class 'B' stock that was issued during or prior to that fiscal year has been called for retirement." 12 USCA Sec. 1134d(a)(3).

When the Bank for Cooperatives retires this Class "C" stock, will the transaction be viewed as a true stock redemption resulting in no taxable income to the holder because redeemed at par, or will the proceeds properly be treated as ordinary income to the recipient because it is in the nature of a dividend? Section 302, IRC relates to the matter of distributions and redemption of stock and provides that the redemption shall be treated as an exchange only if it falls within one or more of the categories listed in sub-section (b), which includes:

- (1) Redemptions not equivalent to dividends.
- (2) Substantially disproportionate redemption of stock.
- (3) Termination of a shareholder's interest.

By the express terms of 12 USCA Sec. 1134(d)(a)(3), any redemption of Class "C" stock would be proportionate and would not terminate a shareholder's interest.

Would a redemption of Class "C" stock be essentially equivalent to a dividend and thus fall outside the pale of Sec. 301? The cases hold that a redemption of stock is equivalent

• a dividend when the practical result of the transaction is to distribute accumulated earnings essentially pro rata among the shareholders while leaving the ownership of the corporation basically the same and when the distribution is not connected with a partial liquidation of the assets of the corporation? See *Keefe v. Cote* (1st Cir. 1954) 213 F. 2d 651 at 656. A redemption of Class "C" stock would be pro rata and would leave the ownership of the Bank for Cooperatives unchanged—each borrower would continue to have one vote only. A partial liquidation occurs under Sec. 346, IRC only when there is a genuine business contraction.

Under 12 USCA Sec. 1134d(a)(3), Class "C" stock would be redeemed out of earnings and would not be the result of a business contraction. From the foregoing, it is manifest that any redemption of Class "C" stock would be essentially equivalent to a dividend and should be treated as ordinary income to the recipient. This tends to show the non-capital nature of Class "C" stock. If Class "C" stock is redeemed, the Bank for Cooperatives must have sufficient earnings to enable it to distribute profits, which then can be called a redemption of Class "C" stock.

Purchase of Class "C" Stock is Deductible as an Ordinary Loss: Even if a court rejected the foregoing arguments and denied a deduction for the required purchase of Class "C" stock as an interest expense under Sec. 163 IRC, nevertheless the required purchase of Class "C" stock is deductible as a loss under Sec. 165 IRC.

In order to make the purchase of Class "C" stock deductible as an ordinary loss, it is necessary to establish two points: (1) that any loss realized is an ordinary loss rather than a capital loss, and (2) that the amount of the loss is equal to the purchase price. In effect, we have shown that Class "C" stock has no market price or value when purchased.

Any Loss on the Purchase of Class "C" Stock is Ordinary Loss: There is no doubt about the fact that any loss suffered on the purchase of Class "C" stock will be an ordinary loss rather than a capital loss. This is for the reason that such stock is purchased by reason of business necessity rather than for investment. There are a number of cases to support this position, and this point is conceded by IRS. See, for example, *Tulane Hardwood Lumber Company*, 24 TC 1146; *Western*

Wine and Liquor Company, 18 TC 1090; *McMillan Mortgage Company*, 36 TC 924; *Weather-Seal, Inc.*, TC Memo 1963-102; *Smith & Weldon Incorporated v. U.S.*, 164 Supp. 605.

Worthlessness of Class "C" Stock: This has been demonstrated in our submission concerning the patronage dividend in Class "C" stock.

Value must be determined at time of issuance: One further point and this is critical. Worthlessness of Class "C" stock must be determined by its value *at time of issuance*—not nine or ten years later with the benefit of hindsight. Thus, worthlessness of Class "C" stock at time of its issuance in 1956 cannot be measured by any value it might have in 1966 by reason of anticipation of its redemption in a few more years. This is fully discussed in our original submission.

SATTERFIELD, SHELL, WILLIAMS AND BUFORD

Attorneys at Law

552 First National Bank Building

Jackson, Mississippi 39205

November 1, 1965

INTERNAL REVENUE SERVICE

Jackson, Mississippi

Attention: Mr. John J. Koch

GENTLEMEN: In connection with the examination of the returns of Mississippi Chemical Corporation and Coastal Chemical Corporation, we are writing to call your attention to the status of Class "C" Stock in the New Orleans Bank for Cooperatives.

The Farm Credit Act of 1955 revised the capital structure of the 12 Banks for Cooperatives and the Central Bank for Cooperatives by providing for three classes of stock. See 12 USCA Sec. 1134d. Class "A" stock is government capital and is held by the Governor of the Farm Credit Administration on behalf of the United States. Class "A" stock was issued in exchange for stock held in the Banks for Cooperatives by the Governor, on the effective date of the Farm Credit Act of 1955.

Class "B" stock is investment stock and provision is made for the payment of dividends not to exceed 4 per cent per annum. It is non-voting stock and it is owned principally by cooperative associations.

Class "C" stock is issued to farmer-cooperatives which borrow from the Banks for Cooperatives. A farmer-cooperative acquires Class "C" stock in two ways in doing business with a Bank for Cooperatives:

- (1) As a patronage dividend. 12 USCA Sec. 1134e(b).
- (2) Required purchase as a condition to a loan. 12 USCA Sec. 1134d(a)(3).

So long as a Bank for Cooperatives has Class "A" stock outstanding, all earnings (after the payment of a franchise tax, setting aside of required reserves and dividends on Class "B" stock) must be allocated to patron-cooperatives as patronage dividends in the form of Class "C" stock. 12 USCA Sec. 1134e(a). When all government capital (Class "A" stock) in a Bank for Cooperatives has been retired, it loses its exemption from income taxes. See 12 USCA Sec. 1138c.

In 1964 Congress passed P.L. 88-528 which amended the law pertaining to patronage dividends of Banks for Cooperatives to provide that, for any fiscal year that a Bank for Cooperatives is subject to Federal income taxes, it shall pay in money rather than Class "C" stock such portion of its taxable income as is necessary to permit it to issue qualified written notices of allocation for the balance. See 12 USCA Sec. 1134e(b).

The Farm Credit Act of 1955 also requires a borrower from a Bank for Cooperatives to invest quarterly in Class "C" stock in an amount equal to not less than 10 per cent nor more than 25 per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the NOBC has provided 15 per cent. Payments for such "C" stock are made quarterly or when the regular interest payments of the borrower are made. See 12 USCA Sec. 1134d(a)(3).

The Internal Revenue Service issued technical information release No. 69 on February 14, 1958, in which it announced that it would conform with the principles enunciated by court decisions in connection with the tax treatment of allocations of patronage dividends by cooperative associations to its patrons. The cases referred to were the *Long Poultry Farms* case (249 F. 2d 726) decided in 1957 and the *Carpenter* case (219 F. 2d 635) decided in 1955. These cases had held that a patron was required to report non-cash patronage dividends received from cooperative associations as income only to the extent that such non-cash patronage refunds had fair market value. Where such

patronage refunds had no fair market value, the patron was not required to include them in his gross income in the year the notice of the non-cash refund was received.

Regulation Sec. 1.61-5 implementing TIR No. 69 became effective December 3, 1959. It provides that non-cash patronage refunds are includable in the gross income of patrons to the extent of the fair market value of the document notifying the patron of the amount of the allocation made to him at the time of its receipt by the patron. *Any document which is payable only at the discretion of the cooperative association or which is otherwise subject to the conditions beyond the control of the patron shall be considered not to have any fair market value at the time of its receipt by the patron, unless it is clearly established to the contrary.*

The following are characteristics of Class "C" stock, which are defined in 7 USCA Sec. 1134d: (sic)

Right to dividends: The law prohibits the payment of dividends on Class "C" stock.

Voting rights: In effect, Class "C" stock is nonvoting. Each holder of one or more shares of Class "C" stock which is eligible to borrow from a Bank for Cooperatives is entitled to one vote, provided, however, that any holder which within the period of 2 years next preceding the cut-off date for voting has not been a borrower from a Bank in which it holds Class "C" stock shall not be entitled to a vote. From this it is clear that it is not the ownership of Class "C" stock which gives a right to vote, but the borrowing from a Bank for Cooperatives. Regardless of how many shares of Class "C" stock a cooperative owns, it still has only one vote.

Possibility of appreciation in value: There is no possibility of any appreciation in value of Class "C" stock since at most it would be worth par at such times as it might be redeemed.

Delivery of stock certificates: No stock certificates have been delivered by the NOBC to MCC or Coastal to evidence ownership of Class "C" stock.

Transferability: Class "C" stock is not transferable, except under very limited conditions. The only known instances of transfers of Class "C" stock in NOBC have been pursuant to a dissolution or merger and then the stock has been transferred at no value.

Market value: There is no market value for Class "C" stock since it has not been sold nor can it be sold for all practical

purposes. Certainly so long as the holder is indebted to the issuing bank, "C" stock would not be marketable because it is impressed with a lien in favor of the Bank. 12 USCA Sec. 1134d(c). The lack of market value will be discussed in more detail later.

Collateral value: Obviously, "C" stock would have no value as collateral with any lender other than the issuer because of the foregoing characteristics. It is important to note, however, that it has no value as collateral even with the issuing Bank. In fact, we have been informed by officials of Banks for Cooperatives that in evaluating the financial position of an applicant for a loan, any value assigned to Class "C" stock by the applicant is disregarded and is not considered an asset.

Class "C" stock is issued as a patronage dividend. Under Reg. Sec. 1.61-5 non-cash dividends received from a cooperative are includable only to the extent of fair market value, and this is presumed to be lacking where redemption rests in the discretion of a board of directors. We believe that it is not open to serious question that Class "C" stock received as a patronage dividend should not be taken into income because of its lack of fair market value.

What will happen when all government capital has been retired? It is my understanding that the Banks for Cooperatives at Berkeley and Houston recently completed the retirement of all government capital and thus will be in a position to begin retirement of Class "C" stock. The NOBC expects to have the last of its government capital retired during the next two or three years. Here is what the law says on retirement of Class "C" stock: "After retirement of all Class "A" stock, Class "C" stock also may be retired at par by calling the oldest outstanding Class "C" stock, but Class "C" stock that was issued for a fiscal year period shall not be called for retirement until all Class "B" stock that was issued during or prior to that fiscal year has been called for retirement." 12 USCA Sec. 1134d(a)(3).

Under 12 USCA Sec. 1134d(a)(3), Class "C" stock would be redeemed out of earnings and would not be the result of a business contraction. If Class "C" stock is redeemed, the Bank for Cooperatives must have sufficient earnings to enable it to distribute profits, which then can be called a redemption of Class "C" stock.

Whether or not there is a redemption of Class "C" stock and to what extent depends upon the following factors:

(1) Future earnings of the Bank. Past or accumulated earnings will not provide funds to retire such stock.

(2) The state of the law relating to Banks for Cooperatives at the time. If, for example, the law were amended to require the payment of all current earnings in cash, no Class "C" stock could be retired.

(3) The discretion of the Board of Directors.

As to the worthlessness of Class "C" stock, we submit the following:

1. Class "C" stock has no market value. It has no market value because no market is maintained in it, and because the owner is virtually prohibited from disposing of it, as was discussed earlier. As mentioned above, the only known instances of transfer of such stock have been at *no value*. Regulations Sec. 1.61-5 which govern the receipt of Class "C" stock as patronage dividends provide that any document which is payable only at the discretion of the issuer, or which is otherwise subject to conditions beyond the control of the patron, shall be considered not to have any fair market value at the time of its receipt by the patron. The law provides that "C" stock is redeemable only at the discretion of the Board of Directors of the Bank for Cooperatives, and redemption is contingent on future earnings of the issuer and on the state of the law at the time. Moreover, there is a special situation in the case of Banks for Cooperatives regarding control of the patrons. The greatest number of directors which patrons of a Bank for Cooperatives can elect is two out of a total of seven. See 12 USCA Sec. 1134, Sec. 640b and 640d. Thus, the patrons of a bank for cooperatives have very little control over its Board of Directors. In the case of most cooperatives, the patrons elect the entire Board of Directors. Thus, we believe we can show conclusively by the government's own regulations that Class "C" stock has no market value.

2. The law prohibits the payment of dividends on Class "C" stock. The most it could ever be worth is its issue price many years later, and this is contingent on factors over which the holder has virtually no control. No voting rights attach to the issuance of additional Class "C" stock. These factors all point to worthlessness.

3. It has no value as collateral for loans. As mentioned above, even the issuing Bank disregards any value assigned to it on the balance sheet of a borrower in analyzing the financial position of the borrower.

We understand from the NOBC that when the government "A" stock is paid up, the outstanding "C" stock is expected to be put on a 13-year or 14-year revolving fund basis.

Value must be determined at time of issuance: One further point and this is critical. Worthlessness of Class "C" stock must be determined by its value *at time of issuance*—not nine or ten years later with the benefit of hindsight.

Thus, worthlessness of Class "C" stock at the time of its issuance cannot be measured by any value it might have in 1965 by reason of anticipation of its redemption in a few more years.

Yours very truly,

JOHN C. SATTERFIELD,
General Counsel
Mississippi Chemical Corporation
Coastal Chemical Corporation

JCS:md:rf

NEW ORLEANS BANK FOR COOPERATIVES

P.O. Box 50072, New Orleans, Louisiana 70150

March 22, 1966

MR. JOHN C. SATTERFIELD, General Counsel
Mississippi Chemical Corporation
P.O. Box 388
Yazoo City, Mississippi 39194

DEAR JOHN: Yesterday in our conversation over the telephone you requested that I write you with reference to the policy of the bank in regard to the retirement of class A (U.S. Government) stock in the bank. In reviewing our files I find that Mr. Nettles in his letter to you of December 22, 1965, covered this subject very thoroughly and pointed out that the retirement of this stock prior to June 30, 1968, was very doubtful.

Subsequent to Mr. Nettles' letter, the staff of the bank again reviewed this subject; and a memorandum covering it was presented to our board at its meeting held on February 25, 1966. A copy of this memorandum is attached. You will observe

that it was recommended that the prepayment of the class A stock through the sale of debentures be deferred until such time as the officers of the bank determine that it will be advantageous to the bank and its borrowers for the board to reconsider this subject. It was also recommended that the program of retiring class A stock adopted on May 20, 1959, be continued. The goals under this program are set out on the first page of the memorandum.

As we now stand the class A stock will be retired annually in the amounts required by law, and under our calculations it will take six or seven years more to retire all of the stock. Should the cost of money decline, it is altogether possible that the board will again consider retiring any outstanding A stock through the sale of debentures.

As requested, I am attaching a schedule of the C stock in the bank issued by years.

Sincerely yours,

/s/ D. R. Stump
D. R. STUMP
Vice President.

DRS:cml
Enclosures

POLICY OF NEW ORLEANS BANK FOR COOPERATIVES ON RETIREMENT OF GOVERNMENT CAPITAL

It is deemed advisable at this time for the board to reconsider and restate the bank's policy regarding the retirement of class A stock in the bank. At the meeting of the board held on May 20, 1959, a program of retiring class A stock over a period of 20 years with full retirement on June 30, 1976, was approved. The goal and actual retirement of stock under this program is presented below.

Fiscal Year Ended June 30	Goal		Actual		Ahead of Schedule
	Retirement	Balance	Retirement	Balance	
Original A Stock		\$7, 000, 000		\$7, 000, 000	
1956 (6 months)	\$71, 900	6, 928, 100	\$71, 900	6, 928, 100	
1957	181, 300	6, 746, 800	181, 300	6, 746, 800	
1958	229, 800	6, 517, 000	229, 800	6, 517, 000	
1959	247, 000	6, 270, 000	247, 000	6, 270, 000	
1960	270, 000	6, 000, 000	300, 000	5, 970, 000	
1961	275, 000	5, 725, 000	350, 000	5, 620, 000	
1962	275, 000	5, 450, 000	350, 000	5, 270, 000	
1963	300, 000	5, 150, 000	390, 000	4, 880, 000	
1964	300, 000	4, 850, 000	450, 000	4, 430, 000	
1965	325, 000	4, 525, 000	660, 000	3, 770, 000	\$755, 000
1966	350, 000	4, 175, 000			
1967	375, 000	3, 800, 000			
1968	400, 000	3, 400, 000			
1969	400, 000	3, 000, 000			
1970	400, 000	2, 600, 000			
1971	400, 000	2, 200, 000			
1972	400, 000	1, 800, 000			
1973	400, 000	1, 400, 000			
1974	400, 000	1, 000, 000			
1975	400, 000	600, 000			
1976 (20 years)	600, 000				

This schedule of class A stock retirement was approved by the board as a general objective with the understanding that, under very high interest rate conditions or in the event of substantial losses on loans, deviations from the schedule would be necessary.

At its meeting held on January 23, 1964, the board was informed that, with the approval of the Governor of the Farm Credit Administration and the Federal Farm Credit Board, the class A stock might be retired ahead of the above mentioned schedule with funds obtained through the sale of debentures. The officers of the bank at that time felt that the prepayment of class A stock would be advantageous to the bank and its borrowers, and the board unanimously approved such retirement as of June 30, 1966. The Federal Farm Credit Board at its February 5, 1964, meeting approved and authorized retirement of

the class A stock of the bank outstanding as of June 30, 1966, or at the close of any subsequent fiscal year. *Upon such retirement the bank was authorized to call and retire the class B stock then outstanding and the oldest class C stock with the provision that the maximum amount of class C stock retired shall not exceed the net cash available from earnings and sale of class C stock for any year less patronage dividends and dividends on capital stock paid in cash.*

Although not specifically stated in the minutes of the meeting of the board at which the prepayment of class A stock through the sale of debentures was approved, it was understood by the board and the bank's officers that a substantial increase in interest rates on debentures would make the prepayment of a large amount of class A stock uneconomical and, in such event, the prepayment should be deferred.

Because of our relations with the Central Bank for Cooperatives through participations, it is not practicable to retire the class A stock in this bank until similar stock in the Central Bank has been retired, which under the present program of the Central Bank will be on June 30, 1968.

Subsequently several of the bank's larger borrowers suggested that consideration be given to a plan under which more of the bank's net earnings could be distributed in cash after the class A stock has been retired. These borrowers expressed interest in a more flexible policy under which a district bank for cooperatives could develop a patronage dividend program designed to fit the needs of its borrowers. It was the judgment of this group that the bank should be on a current cash refund basis and the revolving of class C stock should be minimized and that each borrower be required to invest in class C stock in an amount sufficient to capitalize its loans. This program of permanent capital and larger cash refunds, referred to generally as the cash payment plan, has been approved by over 90 per cent of the bank's stockholders but is not considered favorably by most of the other district banks.

A special committee appointed by the board to study the capital program for the bank reported to the board at its meeting held on November 17, 1965, and recommended that, when permitted by law, borrowers be given a choice between two programs; namely, the cash plan with a type of permanent capital and cash rebates and the revolving plan as now provided

by law. This committee also recommended that legislation necessary to implement this program be sought. After fully considering the recommendations of this committee, the board unanimously approved the same.

From the foregoing it appears that the program for the retirement of class A stock as set out in the schedule attached to the minutes of May 20, 1959, meeting of the board was amended by the action of the board on January 23, 1964, which authorized the prepayment of class A stock on June 30, 1966, with funds obtained through the sale of debentures. The officers of the bank are of the opinion that such prepayment should be deferred for the following reasons:

1. The interest rates on debentures has decreased and the gross interest spread on loans has declined to the extent that retirement through the sale of debentures is not now economically advantageous.

2. It will facilitate operations of the bank to defer retirement of class A stock to such a time as the class A stock of the Central Bank for Cooperatives is retired and the Central Bank begins revolving its C stock or rebating its earnings in cash.

3. The stockholders of the bank have expressed their desire for a cash payment plan, which, if adopted and implemented, would probably affect the decision to repay class A stock.

In view of the foregoing, it is recommended:

1. That the prepayment of class A stock through the sale of debentures be deferred until such time as the officers of the bank determine that it will be advantageous to the bank and its borrowers for the board to reconsider this subject.

2. That, until otherwise determined by the board, the program of class A stock retirement adopted on May 20, 1959, be continued.

(Handwritten notation on bottom of above document: This policy approved by Board of Directors at meeting held on Feb. 25, 1966, and memo made a part of the minutes. /s/DRS)

New Orleans Bank for Cooperatives

Year	C Stock Issued by Year
1956	\$86,589.66
1957	201,274.79
1958	249,660.36
1959	343,929.40
1960	409,598.35
1961	438,209.60
1962	429,003.95
1963	523,191.86
1964	613,410.35
1965	883,505.43
Total	\$4,178,463.75

NEW ORLEANS BANK FOR COOPERATIVES

P.O. Box 50072, New Orleans, Louisiana 70150

December 22, 1965

Mr. JOHN C. SATTERFIELD
 General Counsel
 Mississippi Chemical Corporation
 Post Office Box 388
 Yazoo City, Mississippi 39194

DEAR MR. SATTERFIELD:

Subject: Mississippi Chemical Corporation
 Coastal Chemical Corporation

This refers to your letter of December 7 addressed to Mr. Stump, and also your letter of December 13 addressed to me, pertaining to the Internal Revenue Service examination of the subject associations. You have raised certain questions in each letter. We will discuss the questions in your letter of December 7 first.

As to the agent's first reference "... the bank in its notification of patronage refunds to its shareholders, it is recommended that the amount be reflected at face value and a credit to operating income ..." and also his statement that other cooperatives give full value to the C stock, resulting in tax paid under prior and present law, our recommendation to the cooperative to reflect the stock at face value and credit operating income appears on our annual notice of allocation. A specimen copy is enclosed herewith as Exhibit A for your review.

The purpose of this statement incorporated in our notice is purely from a financial accounting standpoint. We recom-

mended that borrowing cooperatives reflect the face value of our stock on their accounting records simply to show equity as to ownership in the bank. This statement has no significance whatsoever from a tax standpoint as to the value of the stock and was not intended for an opinion as to the value of the stock. In any event the cooperative is free to set up a valuation reserve against this stock upon advice of its attorney and tax accountants. In general, our borrowing cooperatives record C stock (both purchased and received as patronage refunds) at face value. We do know specifically of one other cooperative in this district, other than yourselves, which writes the stock off for tax purposes and, according to information given us, there are cooperatives in other districts which do likewise. Some are purely exempt, i.e., Sec. 521 cooperatives, and the remainder are corporations operating on a cooperative basis. In either case, if the cooperative sets the stock up at face value, the corresponding income would normally be credited to pool earnings but also deducted by the cooperative as a patronage refund except for the nonmember portion; in the case of nonexempt cooperatives. As a result, the cooperative (whether exempt or non-exempt) pays no tax as such on the stock, with the exception noted, but the reporting falls to the patron on a single tax level.

As you know, prior to the adoption of the Revenue Act of 1962, members of cooperatives were not required to report paper patronage refunds at face value but only to the extent of the fair market value of the paper. Until the U.S. Government capital is retired in full, the bank for cooperatives is not subject to the Revenue Act of 1962, and the consent provisions therein, since we are not subject to the payment of income tax until the class A stock is retired. Patronage refunds paid by the bank prior to becoming taxable would apparently come under Regulation 1.61.5 which provides that noncash refunds are includable in the income of patrons to the extent of their fair market value, since the borrower has not consented to report patronage refunds at face value.

With respect to the agent's statement that the stock is utilized in the full amount, in the event of default or foreclosure, just the same as any other collateral having face value, we submit for your review a copy of our letter dated November 17, 1965 to revenue agent John Koch in response to his letter requesting advice as to the collateral value assigned to C stock.

and the bank procedure in the event of default. You will note that our regulations require the offset of stock in the event of default and/or foreclosure only under certain conditions. These are set out in that letter. Generally speaking, the stock is applied only in event of an anticipated loss and only to the extent of the anticipated loss. Any stock in excess of the anticipated loss would be left for normal revolving. The bank could refrain from offsetting the stock against the loan account and wait until the stock is revolved and then apply the proceeds as a reduction of the loss in the year of revolving. This would be more cumbersome accounting and the mere offsetting of the stock against the loan does not in itself give any value to the stock.

With regard to your letter of December 13, your first request is for information pertaining to official action taken by the board of directors and the bank with regard to payment of C stock after all the A stock has been retired. The bank is not permitted to revolve any class C stock, of course, until all class A (U.S. Government) is retired. With respect to this, we enclose a certified copy of an excerpt from the board minutes of May 20, 1959, along with the proposed schedule of class A stock retirements. You will notice that at this meeting, the district board, at the request of the bank's president, approved a goal for final retirement of class A stock as of June 30, 1976, or over a period of 20 years from June 30, 1956. This policy was reaffirmed during the intervening years from 1959 up until January 1964, at which time the board approved the recommendation of bank officials to prepay the Government capital by issuance of consolidated debentures, but not earlier than June 30, 1966. We enclose a certified copy of an excerpt from these minutes for your review. Following that meeting, the Federal Farm Credit board approved the bank's request to retire all class A stock outstanding as early as June 30, 1966 by issuance of debentures. However, this approval provided that the maximum amount of class C stock to be revolved in any fiscal year is limited to the net cash available from earnings and sale of class C stock for that year. A copy of a letter from the Farm Credit Administration evidencing this approval is enclosed. Subsequent to that time, however, it was brought to our attention that the Central Bank would not retire its class A stock any earlier than June 30, 1968. Because of the fact that revolving all C stock of the district bank in cash is generally contingent on the re-

volving of the Central Bank, and because of the recent rise in interest costs and reduction of interest spread, and because most of our cooperatives prefer a cash rebate plan of operations and permanent capital, the banks' executive committee's feeling at this time is that it will not recommend the prepayment of class A stock any earlier than June 30, 1968, or possibly later.

As an observation, I might point out to you that since our official plan was a 20-year plan up until 1964, it would appear that this factor would be of primary significance in determining valuations of Mississippi Chemical Corporation and Coastal Chemical Corporation owned class C stock of the bank acquired prior to 1964.

You have requested information pertaining to any action that the directors of the bank have taken concerning C stock involved in a situation where a cooperative is going out of business or there is a foreclosure of a loan by NOBC. The procedures for retirement under a foreclosure have been discussed previously in this letter.

As to retirements for a cooperative going out of business, the manual permits the bank in the case of liquidation or dissolution of any present or former borrower to retire and cancel the association's stock at the fair book value thereof, not exceeding par, under certain conditions as follows:

1. The retirement of such stock would not unduly affect the financial position of the bank.
2. There is reasonable assurance that the business of the borrower has not been continued under circumstances in which it would be proper and feasible for the successor to acquire and hold the interest of its predecessors in the bank.

However, any such retirements are subject to certain limitations and authorizations. The manual states that the board may give blanket approval for the bank's executive committee to retire up to \$5,000 of C stock without consulting the board as to each such request. Any retirements from \$5,000 to \$25,000 can be made only by prior approval of the board of directors. If the retirement exceeds \$25,000 it has to be approved by the Farm Credit Administration.

Regarding these manual provisions our board, in its meeting of November 15, 1961, approved a policy that it would reserve the right to review each individual case before approval of re-

tirement of stock or any other equities of such borrower rather than give the executive committee blanket approval to retire any amount up to \$5,000. A certified copy of these minutes is attached for your information.

The executive committee as a matter of policy has never recommended to the board to retire any C stock out of order for a liquidating co-op on the basis that this would establish a dangerous precedent and could result in inequities.

We trust this covers all of your questions in each letter, and if we can be of further assistance, let us know.

Very truly yours,

/s/ N. F. Pendleton
N. F. PENDLETON
President

NFP:fm

NEW ORLEANS BANK FOR COOPERATIVES
P.O. Box 50072, New Orleans, Louisiana 70150

July 16, 1965

GENTLEMEN:

Subject: Notification of patronage refund for fiscal year June 30, 1965, payable in Class C stock.

For the year ended June 30, 1965, the bank's earnings, after provision for franchise tax, dividends on Class B stock, and transfers to allocated surplus, amounted to \$480,742.77. In accordance with our bylaws, these earnings are to be distributed in Class C stock to borrowing associations in proportion to the total gross interest earnings. Since our gross interest for this period amounted to \$2,677,084.49, this patronage refund amounts to 17.9577 per cent of the gross interest.

We accordingly wish to officially notify you that your class C stock patronage refund for the year ended June 30, 1965, amounts to \$, and has been set up on the records of the bank. It is our recommendation that this amount be reflected in your records by a debit to investments in C stock in the bank and a credit to your operating income at face value.

For your general information, we present below a statement of your cooperative's investment in the capital accounts of this bank as of the close of business June 30, 1965, after giving effect to the above class C stock patronage refund:

	Balance at June 30, 1964	Changes During Year	Balance at June 30, 1965
Class B stock.....	\$	\$	\$
Class C stock:			
Qualifying share.....	\$	\$	\$
From quarterly investment by co- operative associations (15% of interest).....	\$	\$	\$
From earnings distributed as a patronage refund in C stock.....	\$	\$	\$
Total C stock.....	\$	\$	\$

Your very truly,

/s/ J. C. BURAS
J. C. Buras
Assistant Treasurer

Exhibit A

NOVEMBER 17, 1965

Mr. JOHN J. KOCH
Internal Revenue Agent
U.S. Treasury Department
P.O. Box 1659
Meridian, Mississippi

DEAR MR. KOCH:

Subject: Mississippi Chemical Corporation, Coastal Chemical Corporation, Yazoo City, Mississippi

Reference is made to your letter of November 9 to the bank concerning examination of the income tax returns of the subject cooperatives.

You have inquired whether or not the bank assigns any collateral value to borrower-owned class C stock. The policy of this bank is to assign no value for collateral purposes to class C stock owned by a borrower in determining the loan-base of the applicant.

In the event of default and/or foreclosure of a loan, the bank is authorized under Section 153 of the Bank for Cooperatives' manual to apply the fair value (not exceeding face) of class C

stock owned by the defaulting borrower only under certain conditions, as follows:

1. The borrower has been declared bankrupt;
2. The borrower has had a substantial part of its property placed in the hands of a receiver;
3. The borrower has ceased operation, or
4. The indebtedness of the borrower is considered uncollectible in the judgment of the bank.

If we can be of further assistance on this, please advise.

Very truly yours,

D. M. NETTLES
Vice President and Treasurer

DMN:fm

cc: Mr. John C. Satterfield
General Counsel
Mississippi Chemical Corporation

U.S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
Office of the District Director
P.O. Box 1659, Meridian, Mississippi
November 9, 1965

Mr. NEAL F. PENDLETON, *President*
The New Orleans Bank for Cooperatives
P.O. Box 50072
New Orleans, Louisiana 70150

In Re: Mississippi Chemical Corporation, Coastal Chemical Corporation, Yazoo City, Mississippi

DEAR MR. PENDLETON: In connection with the examination of the Federal income tax returns of the above-named taxpayers the following information is requested:

In granting the approval of the amount loanable, is any value assigned to the "C" stock owned by the borrower. In other words, let us assume that the facilities, forming the basis of appraisal and loan are not sufficient in value to cover the normal value required by your Bank, is the class "C" stock considered in the approval of the amount loanable.

It is assumed, that in the case of default and foreclosure, the face amount of the "C" stock is utilized and applied against the indebtedness.

The information requested is under authority of Section 7602 of the Internal Revenue Code of 1954. Your reply at an early date would be highly appreciated.

Yours truly

/s/ J. J. Koch
JOHN J. KOCH
Internal Revenue Agent

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD
OF DIRECTORS OF THE NEW ORLEANS BANK FOR COOPERATIVES
HELD MAY 20, 1959

In discussing interest rates, Mr. Chavanne mentioned the desirability of having some goal for the rate of class A stock retirement. Each director was handed copy of a schedule (Exhibit 2) showing a proposed program for retirement of class A stock over a period of 20 years. After discussion, motion was made, seconded, and unanimously carried approving this schedule for class A stock retirement as a general objective with the understanding that, under very high interest rate conditions or in the event of some substantial loss on bad loans, the bank would find it necessary to deviate from the schedule rate of retirement.

I hereby certify that the above is a true and exact excerpt from the minutes of the regular meeting of the Board of Directors of the New Orleans Bank for Cooperatives held on May 20, 1959.

Dated this 3rd day of December, 1965.

/s/ C. D. POWELL
Assistant Secretary

N.O.B.C. Program of Class A Stock Retirement

Year Ended	Actual	Goal	
		Retire	Balance
Original A Stock			\$7, 000, 000
6-30-56	\$71, 900	\$71, 900	6, 928, 100
6-30-57	181, 300	181, 300	6, 746, 800
6-30-58	229, 800	229, 800	6, 517, 000
6-30-59		247, 000	6, 270, 000
6-30-60		270, 000	6, 000, 000
6-30-61		275, 000	5, 725, 000
6-30-62		275, 000	5, 450, 000
6-30-63		300, 000	5, 150, 000
6-30-64		300, 000	4, 850, 000
6-30-65		325, 000	4, 525, 000
6-30-66		350, 000	4, 175, 000
6-30-67		375, 000	3, 800, 000
6-30-68		400, 000	3, 400, 000
6-30-69		400, 000	3, 000, 000
6-30-70		400, 000	2, 600, 000
6-30-71		400, 000	2, 200, 000
6-30-72		400, 000	1, 800, 000
6-30-73		400, 000	1, 400, 000
6-30-74		400, 000	1, 000, 000
6-30-75		400, 000	600, 000
6-30-76 (20 years)		600, 000	

**EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD
OF DIRECTORS OF THE NEW ORLEANS BANK FOR COOPERATIVES
HELD JANUARY 23, 1964**

Retirement of Government owned class A stock outstanding at June 30, 1966, by issue of consolidated debentures was next discussed. Schedules covering the subject were handed to each director. Mr. Pendleton mentioned that this topic was covered at length by the Springfield Bank for Cooperatives at the Presidents' conference in Houston, Texas; and, as the Governor of the Farm Credit Administration approved Springfield's request, it was the feeling of the executive committee that the bank should submit a similar recommendation to FCA. The president then explained in detail what effects cashing out the Government owned stock by going into debt would have on the capital structure of the bank and also the entire cooperative bank system. He pointed out that at September 30, 1963, the bank's ratio

of net worth to debentures was .9 to 1 and under the law the ratio could be as high as 8 to 1. It is quite obvious that the bank has more capital than it really needs. If the present program of retiring Government capital is continued, the bank will have by 1973 approximately \$13,000,000.00 of capital, considerably more than the most optimistic projection of loan volume shows will be needed. With regard to the system as a whole, he noted that retirement under this plan in 1966 would reduce the maximum size loan that the system could make to a borrower. Mr. Nettles next presented the effect the proposed retirement would have on the bank's earnings. He noted that it would affect income and earnings to the extent of the interest cost on approximately \$3,500,000.00, the interest earned on Treasury bonds held by the bank would also be taxable; and the bank would be subject to franchise taxes in the three states. Projections indicated that under the proposed plan net earnings would be reduced by approximately \$100,000.00 annually.

At the conclusion of Mr. Nettles' remarks, Mr. Pendleton stated that the executive committee had considered the various aspects of the subject and unanimously recommends that the board approve the retirement of class A stock outstanding at June 30, 1966, by issuance of debentures, subject to the approval of the Farm Credit Administration. After further discussion, motion was made, seconded, and unanimously carried approving the executive committee's recommendation.

I hereby certify that the above is a true and exact excerpt from the minutes of the regular meeting of the Board of Directors of the New Orleans Bank for Cooperatives held on January 23, 1964.

Dated this 21st day of December, 1965.

/s/ C. D. POWELL
Assistant Secretary

FARM CREDIT ADMINISTRATION

Washington, D.C., 20578

February 7, 1964

Mr. NEAL F. PENDLETON, President
New Orleans Bank for Cooperatives
P.O. Box 50072
New Orleans, Louisiana 70150

DEAR MR. PENDLETON: This will confirm our telephone conversation on February 6 in which we advised you that the Federal Farm Credit Board had approved the request of the New Orleans Bank for Cooperatives for permission to accelerate the retirement of class A (Government) stock in the bank.

The resolution adopted by the Federal Board was as follows:

"RESOLVED that an exception be made to the policy previously adopted by this Board on retirement of class A (Government) capital stock in the banks for cooperatives to provide that the Springfield Bank for Cooperatives and the New Orleans Bank for Cooperatives, with the approval of their respective boards of directors and the Farm Credit Administration, may:

(1) Accelerate the retirement of class A (Government) stock in the bank;

(2) Retire, as of June 30, 1966, or at the close of any subsequent fiscal year, any amount of class A (Government) and class B stock then outstanding; and

(3) Upon retirement of all class A (Government) and class B stock each of the banks may call and retire the oldest outstanding class C stock, in full or on a pro-rata basis, in accordance with the provisions of the Farm Credit Act of 1933, as amended by the Farm Credit Act of 1955, but the maximum amount of class C stock retired as of the close of any fiscal year shall not exceed the net cash available for such retirement from earnings and sale of class C stock for the year."

You will observe that the maximum amount of class C stock to be retired in any fiscal year is limited to the net cash available from earnings and sale of class C stock for the year. Therefore, the sources of funds for such retirement would be substantially as follows:

1. Net earnings.

2. Required investment in class C stock paid in cash less the amount of class C stock of the Central Bank purchased on account of participations held by the Central Bank.

3. Cash received from Central Bank in redemption of equities.

Less:

1. Allocations of Central Bank taken into earnings.

2. Cash distribution of current earnings—required by law—

20 percent of the allocated surplus and patronage refunds.

3. Income taxes and dividends paid on capital stock, if any.

We hope that the accelerated retirement of the stock as proposed, which will enable the bank to begin paying 20 percent of its current refunds in cash and revolving borrowers' equities in cash, will aid the bank in obtaining additional business which it might not otherwise get.

Very truly yours,

GLENN E. HEITZ,

Director of Cooperative Bank Service.

**EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD
OF DIRECTORS OF THE NEW ORLEANS BANK FOR COOPERATIVES
HELD NOVEMBER 15, 1961**

The board fully discussed regulations issued by the Farm Credit Administration pertaining to the cancellation and retirement of stock and other equities of a borrower in liquidation or dissolution. The consensus was that for the time being the board would prefer to review each individual case before approving the retirement of stock and other equities of any such borrower.

I hereby certify that the above is a true and exact excerpt from the minutes of the regular meeting of the Board of Directors of the New Orleans Bank for Cooperatives held on November 15, 1961.

Dated this 21st day of December, 1965.

/s/ C. D. POWELL
Assistant Secretary

ATTACHMENT TO AND MADE A PART OF CLAIM: (Form 843)

Filed by: Mississippi Chemical Corporation, P.O. Box 388, Yazoo City, Mississippi

For the fiscal year ended June 30, 1962

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(c) *Interest*

\$16,421.75

The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100. par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to 15 per cent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the above amount.

Cost incurred in purchasing class C stock are not deductible. See Rev. Rul. 65-241.

(d) *Patronage Dividend on "C" stock*

\$27,489.40

The taxpayer received class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The amount was not included in income as having no value.

The Bank, in its notification of patronage refund to its shareholders, recommends that the amount be reflected at face value and a credit to operating income.

The "C" stock is assigned as collateral against loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount,—the same as any other collateral having face value.

The amount above, is therefore includable in income under section 61 of the 1954 Code.

The income tax related to (c) above amounted to \$8,539.31 and was paid as shown by attached copy of letter accompanying the remittance.

The income tax related to (d), amounting to \$14,259.48, was agreed to in Form 870 which was sent to Mr. Julian W. Johnson, Appellate Conferee, Internal Revenue Service, U.S. Treasury Department, 711-2121 Building, 2121-8th Avenue, North, Birmingham, Alabama 35203. The above amount of income tax was paid July 21, 1967 as part of a check for \$17,954.84, which included applicable interest.

It was understood with Mr. Johnson that the execution and filing of the foregoing Form 870 would not preclude the filing of a Claim (Form 843). In fact it was understood that a claim would be filed as a basis of litigation in the applicable U.S. District Court.

The total income tax represented by (c) and (d) above amounts to \$22,798.79 shown as (g) on Form 843.

It is claimant's position that the interest represented by (d) was deductible and further that the class C stock referred to was not worth \$100.00 per share during the fiscal year ended June 30, 1962.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1961 and 1963.

ATTACHMENT TO AND MADE A PART OF CLAIM: (FORM 843)

Filed by: Mississippi Chemical Corporation, P. O. Box 388,
Yazoo City, Mississippi

For the fiscal year ended June 30, 1963

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(d) *Interest*

\$18,863.35

The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100. par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to 15 per cent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the above amount.

Cost incurred in purchasing class C stock is not deductible. See Rev. Rul. 65-241.

(e) *Patronage Dividend on "C" stock*

\$25,152.83

The taxpayer received class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The amount was not included in income as having no value.

The Bank, in its notification of patronage refund to its shareholders, recommends that the amount be

reflected at face value and a credit to operating income.

The "C" stock is assigned as collateral against loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount, — the same as any other collateral having face value.

The amount above, is therefore includable in income under section 61 of the 1954 Code.

The income tax related to (d) above amounted to \$9,808.93 and was paid as shown by attached copy of letter accompanying the remittance.

The income tax related to (e), amounting to \$11,304.94, was agreed to in Form 870 which was sent to Mr. Julian W. Johnson, Appellate Conferee, Internal Revenue Service, U.S. Treasury Department, 711-2121 Building, 2121-8th Avenue, North, Birmingham, Alabama 35203. The above amount of income tax was paid July 21, 1967 as part of a check for \$13,478.19, which included applicable interest.

It was understood with Mr. Johnson that the execution and filing of the foregoing Form 870 would not preclude the filing of a Claim (Form 843). In fact it was understood that a claim would be filed as a basis of litigation in the applicable U.S. District Court.

The total income tax represented by (d) and (e) above amounts to \$21,113.87 shown as (g) on Form 843.

It is claimant's position that the interest represented by (d) was deductible and further that the class C stock referred to was not worth \$100.00 per share during the fiscal year ended June 30, 1963.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi, should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1961 and 1962.

In the United States District Court for the Southern Judicial
District of Mississippi, Western Division

Civil Action No. 1214

COASTAL CHEMICAL CORPORATION, PLAINTIFF
vs.

THE UNITED STATES OF AMERICA, DEFENDANT

COMPLAINT

(Filed Dec. 15, 1967)

COUNT I

COMES Coastal Chemical Corporation, a corporation organized under the laws of the State of Mississippi, and files this suit against The United States of America and for cause of action says:

I.

Plaintiff is a corporation organized under the laws of the State of Mississippi with its domicile and principal place of business in Yazoo City, Mississippi, in the Southern District of Mississippi, Western Division, of the United States District Court.

II.

Defendant is The United States of America upon whom service of process may be had by service of summons upon the United States District Attorney of Jackson, Mississippi, and by sending a copy of the summons and complaint to the Attorney General of the United States at Washington, D.C.

III.

This is an action of a civil nature for the recovery of United States income taxes and interest paid thereon, which income taxes and interest were erroneously or illegally assessed and wrongfully collected.

IV.

Plaintiff is organized under the General Corporate Laws of the State of Mississippi but is a cooperative qualified to receive financing under the Statutes of the United States of America as a cooperative. It is and since the beginning of its

operation has been engaged in manufacturing fertilizer and distributing same primarily to its stockholder patrons.

V.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1961, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$40,779.88 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d (a) (3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$40,779.88 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d (a) (3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1961, the sum of \$51,689.59 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 1134l(b) of Title 12, United States Code.

VI.

The said Revenue Agent's report reduced plaintiff's net operating loss deduction by disallowing as deductions amounts paid to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code (as described in paragraph V(a) above), and by including in plaintiff's income the face amount of Class C stock received as patronage dividends from the New Orleans Bank for Cooperatives (as described in paragraph V(b) above), for the following fiscal years in the amounts stated, to-wit:

(a) Fiscal year ended June 30, 1958:

(1) Disallowed deduction of \$11,670.19 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(b) Fiscal year ended June 30, 1959:

(1) Disallowed deduction of \$33,474.20 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134(a)(3) of Title 12, USC.

(2) Included as income \$14,345.04 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(c) Fiscal year ended June 30, 1960:

(1) Disallowed deduction of \$46,172.23 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$47,361.32 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

That as a result of the above described adjustments, plaintiff's net operating loss carry forward was reduced and plaintiff for fiscal year ending June 30, 1961, paid additional income taxes of \$231.00 plus applicable interest of \$63.34.

Plaintiff alleges that its net operating loss deduction should not be reduced as set forth in said Revenue Agent's report and that plaintiff's net operating loss deduction and carry forward for fiscal years ended June 30, 1957, June 30, 1958, June 30, 1959, June 30, 1960, and June 30, 1961, should be computed in accordance with Exhibit A which is attached hereto and made a part hereof as if copied herein and that said net operating loss deduction carried forward should be \$827,744.28 as of June 30, 1960, and should be \$244,681.92 as of June 30, 1961.

VII.

The Farm Credit Act of 1955 (Section 1134(d)(a)(3) title 12, USC) requires a borrower from a Bank for Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a payment of fifteen per cent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1961, plaintiff paid the New Orleans Bank for Cooperatives \$40,779.88 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was

required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d(a)(3) of Title 12, United States Code. Plaintiff show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1961, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said bank for said payment had no market value for the reasons hereinafter set forth.

VIII.

Section 1134l(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1961, plaintiff borrowed money from the New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as patronage dividends in the stated amount of \$51,689.59. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$51,689.59 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30 1961.

IX.

(a) That the amounts paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal years ending June 30, 1958, through June 30, 1961, inclusive, as hereinabove set forth, for the privilege of borrowing from said Bank are proper deductible expenses either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold

or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends for the fiscal years ending June 30, 1958 through June 30, 1961, inclusive, as hereinabove set forth, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

X.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1961, and the adjustments to plaintiff's net operating loss carry forward, plaintiff paid additional income taxes of \$231.00 plus applicable interest of \$63.34 thereon for its fiscal year ending June 30, 1961. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$231.00 was erroneous, and the aforesaid reduction of plaintiff's net operating loss for the fiscal years ending June 30, 1958 through June 30, 1961, inclusive, was erroneous.

XI.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1961, said Claim being for a refund of income taxes erroneously assessed and paid in the amount of \$231.00 plus applicable interest of \$63.34, and said Claim requested a computation of plaintiff's net operating loss for fiscal years ending June 30, 1958, June 30, 1959, June 30, 1960, and June 30, 1961, in accordance with Exhibit A attached hereto and made a part hereof. Said Claim for Refund (including all Exhibits attached thereto) is attached hereto as Exhibit B and made a part hereof as if copied herein.

XII.

That by Certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending June 30, 1961 had been denied. There is attached hereto as Exhibit C letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1961.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$231.00 and applicable interest paid of \$63.34 and interest thereon as allowed by law; and plaintiff prays that its net operating loss deduction be computed and allowed for fiscal years ending June 30, 1958 through June 30, 1961, inclusive, in accordance with Exhibit A attached hereto; and for costs of this action, and for such other and further relief as to the Court may seem just and proper.

COUNT II

I.

Plaintiff re-alleges and re-avers each and every allegation of paragraphs I through IV of Count I above.

II.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1962, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$34,116.16 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$34,116.16 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1962, the sum of

\$60,541.52 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 1134 l(b) of Title 12, United States Code.

III.

The said Revenue Agent's report reduced plaintiff's net operating loss deduction by disallowing as deductions amounts paid to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code (as described in paragraph II(a) above), and by including in plaintiff's income the face amount of Class C stock received as patronage dividends from the New Orleans Bank for Cooperatives (as described in paragraph II(b) above), for the following fiscal years in the amounts stated, to-wit:

(a) Fiscal year ended June 30, 1958:

(1) Disallowed deduction of \$11,670.19 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(b) Fiscal year ended June 30, 1959:

(1) Disallowed deduction of \$33,474.20 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$14,345.04 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(c) Fiscal year ended June 30, 1960:

(1) Disallowed deduction of \$46,172.23 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$47,361.32 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(d) Fiscal year ended June 30, 1961:

(1) Disallowed deduction of \$40,779.88 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$51,689.59 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

That as a result of the above described adjustments, plaintiff's net operating loss carry forward to fiscal year ended June 30, 1962, was reduced. Plaintiff alleges that its net operating loss deduction should not be reduced as set forth in said Revenue Agent's report and that plaintiff's net operating loss deduction and carry forward for fiscal years ended June 30, 1957, June 30, 1958, June 30, 1959, June 30, 1960, and June 30, 1961, should be computed in accordance with Exhibit A which is attached hereto and made a part hereof as if copied herein and that said net operating loss deduction carried forward should be \$244,681.92 as of June 30, 1961.

IV.

The Farm Credit Act of 1955 (Section 1134d(a)(3) of Title 12, USC) requires a borrower from a Bank of Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent, nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a payment of fifteen per cent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1962, plaintiff paid the New Orleans Bank for Cooperatives \$34,116.16 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d(a)(3) of Title 12, United States Code. Plaintiff would show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1962, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said Bank for said payment had no market value for the reasons hereinafter set forth.

V.

Section 1134 1(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1962, plaintiff borrowed money from the New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as patronage dividends in the stated amount of \$60,541.52. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$60,541.52 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30, 1962.

VI.

(a) That the amounts paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal years ending June 30, 1958 through June 30, 1962, inclusive, as hereinabove set forth, for the privilege of borrowing from said Bank are proper deductible expenses either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends for the fiscal years ending June 30, 1958 through June 30, 1962, inclusive, as hereinabove set forth, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that

no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

VII.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1962, and the adjustments to plaintiff's net operating loss carry forward, plaintiff paid additional income taxes of \$174,478.04 plus applicable interest of \$39,605.60 thereon for its fiscal year ending June 30, 1962. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$174,478.04 was erroneous, and the aforesaid reduction of plaintiff's net operating loss for the fiscal years ending June 30, 1958 through June 30, 1962, inclusive, was erroneous. There is attached hereto as Exhibit D a computation of the taxes for which refund is claimed.

VIII.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1962, said Claim being for a refund of income taxes erroneously assessed and paid in the amount of \$174,478.04 plus applicable interest of \$39,605.60, and said Claim requested a computation of plaintiff's net operating loss for fiscal years ending June 30, 1958, June 30, 1959, June 30, 1960, June 30, 1961, and June 30, 1962, in accordance with Exhibit A attached hereto and made a part hereof. Said Claim for Refund for fiscal year ending June 30, 1962 (including all Exhibits attached thereto), is attached hereto as Exhibit E and made a part hereof as if copied herein.

IX.

That by Certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending June 30, 1962, had been denied. There is attached hereto as Exhibit F letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1962.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$174,478.04 and applicable interest paid of \$39,605.60 and interest thereon as allowed by law; and plaintiff prays that its net operating loss deduction be computed and allowed for fiscal years ending June 30, 1958 through June 30, 1962, inclusive, in accordance with Exhibit A attached hereto; and for costs of this action, and for such other and further relief as to the Court may seem just and proper.

COUNT III

I.

Plaintiff re-alleges and re-avers each and every allegation of paragraphs I through IV of Count I above.

II.

(a) Plaintiff duly filed its Federal income tax return for its fiscal year ending June 30, 1963, on or before the due date thereof with the District Director of Internal Revenue at Jackson, Mississippi. On said tax return, plaintiff deducted from its gross income the amount of \$41,207.02 which plaintiff had been required to pay during such fiscal year to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code. On or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to plaintiff and in said report the Revenue Agent erroneously disallowed the deduction of \$41,207.02 which plaintiff had been required to pay to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code.

(b) In said Revenue Agent's report (dated January 10, 1966), the Revenue Agent erroneously included in plaintiff's income for the fiscal year ended June 30, 1963, the sum of \$52,305.05 as the alleged value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends in accordance with Section 1134l(b) of Title 12, United States Code.

III.

The said Revenue Agent's report reduced plaintiff's net operating loss deduction by disallowing as deductions amounts

paid to the New Orleans Bank for Cooperatives under the provisions of Section 1134d(a)(3) of Title 12, United States Code (as described in paragraph II(a) above), and by including in plaintiff's income the face amount of Class C stock received as patronage dividends from the New Orleans Bank for Cooperatives (as described in paragraph II(b) above) for the following fiscal years in the amounts stated, to-wit:

(a) Fiscal year ended June 30, 1958:

(1) Disallowed deduction of \$11,670.19 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(b) Fiscal year ended June 30, 1959:

(1) Disallowed deduction of \$33,474.20 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$14,345.04 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(c) Fiscal year ended June 30, 1960:

(1) Disallowed deduction of \$46,172.23 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3), of Title 12, USC.

(2) Included as income \$47,361.32 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(d) Fiscal year ended June 30, 1961:

(1) Disallowed deduction of \$40,779.88 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$51,689.59 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

(e) Fiscal year ended June 30, 1962:

(1) Disallowed deduction of \$34,116.16 in connection with payment of interest to New Orleans Bank for Cooperatives under Section 1134d(a)(3) of Title 12, USC.

(2) Included as income \$60,541.52 received as patronage dividend in Class C stock of the New Orleans Bank for Cooperatives.

That as a result of the above described adjustments, plaintiff's net operating loss carry forward to fiscal year ended June 30, 1963, was reduced. Plaintiff alleges that its net operating loss deduction should not be reduced as set forth in said Revenue Agent's report and that plaintiff's net operating loss deduction and carry forward for fiscal years ended June 30, 1957, June 30, 1958, June 30, 1959, June 30, 1960, June 30, 1961, and June 30, 1962, should be computed in accordance with Exhibit A which is attached hereto and made a part hereof as if copied herein and utilized as set forth in Exhibits D and G attached hereto.

IV.

The Farm Credit Act of 1955 (Section 1134d(a)(3) of Title 12, USC) requires a borrower from a Bank for Cooperatives to purchase quarterly Class C stock of such Bank in an amount equal to not less than ten per cent nor more than twenty-five per cent of the amount of interest payable by it to the Bank during such calendar quarter. The Board of Directors of the New Orleans Bank for Cooperatives has provided for a payment of fifteen per cent of the amount of interest payable to said Bank by organizations borrowing from it. During the fiscal year ended June 30, 1963, plaintiff paid the New Orleans Bank for Cooperatives \$41,207.02 for such Class C stock and plaintiff deducted said amount from its gross income. Plaintiff was required to pay said amount to the New Orleans Bank for Cooperatives in connection with interest payments under the provisions of Section 1134d(a)(3) of Title 12, United States Code. Plaintiff would show that said payments were properly deductible from its gross income for fiscal year ended June 30, 1963, either as additional interest paid to said New Orleans Bank for Cooperatives, or as ordinary and necessary business expense, or as a loss on a transaction entered into for profit, and that the Class C stock received by the plaintiff from said Bank for said payment had no market value for the reasons hereinafter set forth.

V.

Section 1134l(b) of Title 12, United States Code, provides for the issuance by a Bank for Cooperatives of patronage refunds to organizations borrowing from such Bank. During fiscal year ending June 30, 1963, plaintiff borrowed money from the

New Orleans Bank for Cooperatives and plaintiff received Class C stock from the New Orleans Bank for Cooperatives as patronage dividends in the stated amount of \$52,305.05. The Class C stock received by plaintiff from said Bank as patronage refunds has no market value (as hereinafter set forth) and the taxpayer included same in its income tax return for said fiscal year at \$1.00 per share for identification purposes only. Plaintiff would show that said \$52,305.05 received as Class C stock of said Bank should not be included in its taxable income for fiscal year ended June 30, 1963.

VI.

(a) That the amounts paid by plaintiff to the New Orleans Bank for Cooperatives for the fiscal years ending June 30, 1958 through June 30, 1963, inclusive, as hereinabove set forth, for the privilege of borrowing from said Bank are proper deductible expenses either as additional interest paid, or as an ordinary and necessary business expense, or as a loss on a transaction entered into for profit; that at the time of such purchase, the Class C stock of the New Orleans Bank for Cooperatives was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

(b) That the Class C stock received by plaintiff from the New Orleans Bank for Cooperatives as patronage dividends for the fiscal years ending June 30, 1958 through June 30, 1963, inclusive, as hereinabove set forth, should not be included in plaintiff's income since such Class C stock had no market value; that at the time of such purchase, the Class C stock was not actually corporate stock at all and was entirely worthless; that no certificates of any nature were issued therefor; that no dividends were or could be payable thereon; that no voting rights were incident thereto; that there was no possibility of appreciation in value; that such Class C stock could not be sold or transferred and the issuer thereof refused to consider it as collateral for loans; and that as a result said so-called Class C stock had no fair market value.

VII.

As a result of the herein described adjustments to plaintiff's taxable income for fiscal year ending June 30, 1963, and the adjustments to plaintiff's net operating loss carry forward, plaintiff paid additional income taxes of \$41,422.10 plus applicable interest of \$7,718.62 thereon for its fiscal year ending June 30, 1963. The aforesaid determination by defendant of a deficiency in plaintiff's income tax of \$41,422.10 was erroneous, and the aforesaid reduction of plaintiff's net operating loss for the fiscal years ending June 30, 1958 through June 30, 1963, inclusive, was erroneous. There is attached hereto as Exhibit G a computation of the taxes for which refund is claimed.

VIII.

On or about October 12, 1967, plaintiff filed its Claim for Refund for fiscal year ending June 30, 1963, said Claim being for a refund of income taxes erroneously assessed and paid in the amount of \$41,422.10 plus applicable interest of \$7,718.62, and said Claim requested a computation of plaintiff's net operating loss for fiscal years ending June 30, 1958, June 30, 1959, June 30, 1960, June 30, 1961, June 30, 1962, and June 30, 1963, in accordance with Exhibit A attached hereto and made a part hereof. Said Claim for Refund for fiscal year ending June 30, 1963 (including all Exhibits attached thereto), is attached hereto as Exhibit H and made a part hereof as if copied herein.

IX.

That by Certified letter dated December 13, 1967, plaintiff was notified that its Claim for Refund for fiscal year ending June 30, 1963, had been denied. There is attached hereto as Exhibit I letter from the District Director of Internal Revenue, Jackson, Mississippi, denying plaintiff's said Claim for Refund for fiscal year ending June 30, 1963.

WHEREFORE, plaintiff prays judgment against the defendant in the amount of \$41,522.10 and applicable interest paid of \$7,718.62 and interest thereon as allowed by law; and plaintiff prays that its net operating loss deduction be computed and allowed for fiscal years ending June 30, 1958 through June 30, 1963, inclusive, in accordance with Exhibit A attached hereto, and as herein set forth, and for costs of this action, and for

such other and further relief as to the Court may seem just and proper.

/s/ John C. Satterfield

JOHN C. SATTERFIELD

Attorney for Coastal Chemical Corporation

P.O. Box 466, Masonic Building

Yazoo City, Mississippi

Of Counsel:

J. DUDLEY BUFORD,

Satterfield, Shell, Williams and Buford

P.O. Box 1172

Jackson, Mississippi

HOLLAMAN M. RANEY

P.O. Box 388

Yazoo City, Mississippi

ATTACHMENT TO AND MADE A PART OF CLAIM (Form 843)

Submitted by: Coastal Chemical Corporation, Box 388, Yazoo City, Mississippi

For fiscal year ended June 30, 1961

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(a) Interest

\$40,779.88

The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100 par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to .15 percent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the amount shown above.

Cost incurred in purchasing class C stock is not deductible. See Rev. Rul. 65-241.

(b) Patronage Dividend on "C" stock

\$51,689.59

The taxpayer received Class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The dividend was not included in income—as having no value.

The New Orleans Bank, in its notification of patronage refund to its shareholders, recommends that the amount be reflected at face value and a credit to operating income.

The "C" stock is assigned as collateral against outstanding loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount—the same as any other collateral having face value. The dividend above, is therefore includable in income under section 61 of the 1954 Code.

As the result of the Agent's adjustments an income tax of \$231.00 was paid on April 7, 1966 together with \$63.34 interest; this was included in a check for \$83,211.24 which included the payment of other items related to the next fiscal year ended June 30, 1962. The small amount of income tax for the fiscal year ended June 30, 1961 is due to the application of a net operating loss deduction, all as set out in the Agent's report referred to above.

It is claimant's position that the interest represented by (a) was deductible and further that the Class C stock referred to in (b) was not worth \$100.00 per share during the fiscal year ended June 30, 1961. It is also claimant's position that the net operating loss deduction allowed by the Revenue Agent in his report and calculations for the fiscal year ended June 30, 1961 should be increased to allow for claimant's position with respect to "Interest" and "Patronage Dividends" for prior fiscal years as follows as shown by the Agent's report:

Fiscal year ended June 30, 1960: (Schedule 4)

(b) <i>Interest</i>	\$46,172.23
(c) <i>Patronage Dividend</i>	47,361.32

Fiscal year ended June 30, 1959: (Schedule 3)

(e) <i>Interest</i>	\$33,474.20
(f) <i>Patronage Dividend</i>	14,345.04

Fiscal year ended June 30, 1958: (Schedule 2)

(d) <i>Interest</i>	\$11,670.19
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On the basis of the foregoing there would be no income tax payable for the fiscal year ended June 30, 1961, and this claim

is simply for the amount paid, namely \$231.00. See attached copy of Exhibit A which is a part of Claim for the fiscal year ended June 30, 1962; it shows the computations indicating no taxable income for the fiscal year ended June 30, 1961.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event, John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi, should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1962 and 1963.

ATTACHMENT TO AND MADE A PART OF CLAIM (Form 843)

Submitted by: Coastal Chemical Corporation, Box 388, Yazoo City, Mississippi

For fiscal year ended June 30, 1962.

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(b) Interest

\$34,116.16

The above adjustment is the same as for prior years* and represents the costs of acquiring additional "C" stock in the New Orleans Bank for Cooperatives and which was claimed as an interest deduction.

*The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100 par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to 15 percent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the amount shown above.

Cost incurred in purchasing class C stock is not deductible. See Rev. Rul. 65-241.

(c) Patronage Dividend "C" Stock

\$60,541.52

The above adjustment is also the same as for prior years* and is the class C stock received from

the New Orleans Cooperative Bank during the year, as a patronage dividend.

*The taxpayer received class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The dividend was not included in income—as having no value.

The New Orleans Bank, in its notification of patronage refund to its shareholders, recommends that the amount be reflected at face value and a credit to operating income.

The "C" stock is assigned as collateral against outstanding loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount—the same as any other collateral having face value. The dividend above, is therefore includable in income under section 61 of the 1954 Code.

It is claimant's position that the interest represented by (b) was deductible and further that the Class C stock referred to in (c) was not worth \$100.00 per share during the fiscal year ended June 30, 1962. In line with the foregoing, claimant takes the position that the net operating loss deduction eliminated by the Revenue Agent in his report should be recomputed as shown by the attached Exhibit A, which gives effect to the position of claimant with respect to "Interest" and "Patronage Dividends" in prior years, and thus restores a net operating loss deduction to the extent shown in Exhibit A. The recomputed Net Operating Loss Deduction is simply the amount claimed by taxpayer in the fiscal years ended June 30, 1962 and June 30, 1963, adjusted for all changes made by Revenue Agent other than those called "Interest" and "Patronage Dividends". The carry-over loss originally claimed by taxpayer for the fiscal year ended June 30, 1963 is eliminated entirely.

In Exhibit B the net income basic to this claim is computed, along with the related income tax, income taxes paid, and the resulting amount of this claim.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event, John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi, should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1961 and 1963.

ATTACHMENT TO AND MADE A PART OF CLAIM (Form 843)
Submitted by: Coastal Chemical Corporation, Box 388, Yazoo
City, Mississippi

For Fiscal Year ended June 30, 1963

In Revenue Agent's report dated January 10, 1966, submitted to the above named taxpayer under date of March 14, 1966, said report covering the period set out above, exceptions were taken as follows:

(b) *Interest \$41,207.02*

The above adjustment is the same as for prior years* and represents the cost of acquiring additional "C" stock in the New Orleans Bank for Cooperatives and which was claimed as an interest deduction.

*The taxpayer acquired one share of class C stock in the New Orleans Bank for Cooperatives (\$100. par value) in order to obtain loans from the Bank. Each borrower must also purchase additional "C" stock in an amount equal to 15 percent of interest paid on its loan. The taxpayer claimed the cost of acquiring the additional "C" stock as interest in the amount shown above.

Cost incurred in purchasing class C stock is not deductible. See Rev. Rul. 65-241.

(c) *Patronage Dividend "C" Stock \$52,305.05*

The above adjustment is also the same as for prior years* and is the class C stock received from the New Orleans Cooperative Bank during the year.

*The taxpayer received class C stock from the New Orleans Cooperative Bank as patronage dividends in the amount stated above. The dividend was not included in income—as having no value. The New Orleans Bank, in its notification of patronage refund to its shareholders, recommends that the amount be reflected at face value and a credit to operating income. The "C" stock is assigned as collateral against outstanding loans, and in the event of default and/or foreclosure of a loan, the stock is utilized in the face amount—the same as any other collateral having face value. The dividend above, is, therefore includable in income under section 81 of the 1954 Code.

It is claimant's position that the interest represented by (b) was deductible and further that the Class C Stock referred

to in (c) was not worth \$100.00 per share during the fiscal year ended June 30, 1963.

On the basis of claimant's position, the corrected taxable income is shown by Exhibit A, which also shows the corrected income tax, income taxes paid and amount of refund.

An expeditious handling of this claim is requested; a conference with claimant's attorney is requested, and will be arranged for promptly on request, in which event, John C. Satterfield, Attorney-at-Law, Box 466, Yazoo City, Mississippi, should be accordingly notified.

Similar claims are being filed by claimant for the fiscal years 1961 and 1962.

Exhibit A.

Taxable Income, Related Income Taxes, Income Taxes Paid and Refund Claimed, Coastal Chemical Corporation, Yazoo City, Mississippi, for the fiscal year ended June 30, 1963

	Income per sch. 11 of revenue agent's report	As determined by appellate	Changes per this claim	Net income as basis of this claim
Taxable income per original return.....	\$250, 493. 81	\$250, 493. 81		\$250, 493. 81
Changes by Revenue Agent:				
(a) Cost of Sales— decrease..	\$14, 522. 94	\$14, 522. 94		\$14, 522. 94
(b) Interest.....	41, 207. 02	41, 207. 02	(\$41, 207. 02)	
(c) Patronage Dividend..	52, 305. 05	52, 305. 05	(52, 305. 05)	
(d) Patronage refund deduction..	209, 223. 44	139, 482. 29		139, 482. 29
(e) Net operat- ing loss deduction..	22, 777. 21	22, 777. 21		22, 777. 21
	\$340, 035. 66	\$270, 294. 51		\$176, 782. 44
	\$590, 529. 47	\$520, 788. 32		\$427, 276. 25

Exhibit A—Continued

Taxable Income, Related Income Taxes, Income Taxes Paid and Refund Claimed, Coastal Chemical Corporation, Yazoo City, Mississippi, for the fiscal year ended June 30, 1963—Continued

	Income per sch. 11 of revenue agent's report	As determined by appellate	Changes per this claim	Net income as basis of this claim
(f) Deprecia- tion.....	\$2,687.90	\$2,687.90		\$2,687.90
Unused				
Contribu- tions car- ried over from f.y. 6-30-61.....			3,193.68	3,193.68
	\$2,687.90	\$2,687.90		\$5,881.58
Corrected tax- able income.....	\$587,841.57	\$518,100.42		\$421,394.67
Tax on \$421,394.67:				
Taxable Income.....			\$421,394.67	
Less: Long term capital gain.....			172,584.17	
			\$248,810.50	
Tax on \$248,810.50.....				\$123,881.46
25% of tax on \$172,584.17.....				43,146.04
Total Tax.....				\$167,027.50
Less: Investment Credit—				
Per Schedule.....				24,546.48
Balance.....				\$142,481.02
Taxes paid:				
With return.....			\$63,722.34	
April 4, 1966.....			*12,750.94	
April 7, 1966.....			*21,105.48	
July 18, 1967.....			86,324.36	183,903.12
Refund claimed.....				(\$41,422.10)

*Per copies of letters attached.

**Coastal Chemical Corporation—Schedule 14—Y/E 6/30/63—Computation of
Investment Credit**

	Cost	Ratable share	Qualified portion	Qualified investment
Qualified Property:				
NEW—				
4 to 6 years.....	\$94,966.54	6.291	5,974.35	1,991.45
6-8.....	7,538.68	6.291	474.26	316.18
8 or more.....	5,488,073.22	6.291	345,254.69	345,254.69
				347,562.32
USED—				
8 or more				
98.609 X 50,000..	\$49,304.50	6.291	3,161.75	3,101.75
				\$350,664.07
Investment Credit 7%.....				24,546.48
Taxable income—				
amended.....			421,394.67	6.291%
Patronage re-				
fund—				
amended.....			6,277,028.10	
			6,698,422.77	

COASTAL CHEMICAL CORPORATION

Post Office Box 388
Yazoo City, Mississippi 39194

April 4, 1966

Mr. J. G. MARTIN, Jr.
District Director
Internal Revenue Service
U.S. Treasury Department
301 North Lamar Street
Jackson, Mississippi 39202

Re: Your File For, L-191B-430:VBH:mnM, Coastal Chemical Corporation, Yazoo City, Mississippi

DEAR SIR: We have received copy of an examination report explaining proposed adjustments in the tax liability of Coastal

Chemical Corporation, letter of transmittal being dated March 14, 1966. This includes page 5 showing "Computation of Income Tax for Partial Agreement" which has been computed in accordance with Form 870 executed by Coastal Chemical Corporation on December 14, 1965, showing the amount of tax for the fiscal years detailed below, on which we have calculated the interest as follows:

Additional tax and interest on "agreed" items:

Fiscal year 6/30/62:	
Tax	\$21,219.85
Interest	4,496.24
Fiscal year 6/30/63:	
Tax	12,750.94
Interest	1,936.75
Total	\$40,403.58

We therefore enclose herein check of Coastal Chemical Corporation in the sum of \$40,403.58 covering the principal and interest on the deficiencies thus agreed.

Yours very truly,

COASTAL CHEMICAL CORPORATION
By JOHN C. SATTERFIELD
General Counsel

EXHIBIT I

U.S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
District Director, 301 North Lamar Street
Jackson, Mississippi 39202

Certified Mail

In reply refer to
COASTAL CHEMICAL CORPORATION
Box 388
Yazoo City, Mississippi

In Re: Claim for refund of \$41,422.10 for the period June 30, 1963

GENTLEMEN: In accordance with the provisions of existing internal revenue laws, this notice of disallowance in full of your claim or claims is hereby given.

No suit or proceeding in any court for the recovery of any internal revenue tax, penalty, or other sum which is a part of the claim for which this notice of disallowance is issued, may be begun after the expiration of two years from the date of mailing of this letter.

Very truly yours,

DISTRICT DIRECTOR

In the United States District Court for the Southern District
of Mississippi, Western Division

Civil Action No. 1214

COASTAL CHEMICAL CORPORATION, APPELLEE

v.

UNITED STATES OF AMERICA, APPELLANT

ANSWER

Comes now the defendant, the United States of America, by its attorney, Robert E. Hauberg, United States Attorney for the Southern District of Mississippi, and for its answer to the plaintiff's complaint herein, admits, denies and alleges as follows:

COUNT I

For answer to Count I of the complaint, the defendant says:

I.

Admits the allegations contained in paragraph I.

II.

Denies the allegations contained in paragraph II for the reason that the complaint attacks the validity of a determination of an officer of the United States, and thus, pursuant to Rule 4(d)(4) of the Federal Rules of Civil Procedure, a copy of the summons and of the complaint must be sent by registered or certified mail to such officer.

III.

Admits the allegations contained in paragraph III, except denies that the income taxes and interest sought to be recov-

ered by the plaintiff were erroneously or illegally assessed and wrongfully collected.

IV.

Denies the allegations contained in paragraph IV for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof, except admits that plaintiff is organized under the general corporate laws of the State of Mississippi.

V.

(a) With respect to the allegations contained in subparagraph (a) of paragraph V, the defendant answers as follows:

Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

(b) Denies the allegations contained in subparagraph (b) of paragraph V, except admits that in said Revenue Agent's report (dated January 10, 1966), the Revenue Agent included in the plaintiff's income for the fiscal year ended June 30, 1961, the sum of \$51,689.59 as the value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by the plaintiff from the New Orleans Bank for Cooperatives as patronage dividends.

VI.

With respect to the allegations contained in paragraph VI, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the Revenue Agent's report and the statute referred to therein speak for themselves.

Denies the allegations contained in the second sentence for the reason that the adjustments referred to therein speak for themselves and for the further reason that the defendant is presently without information or knowledge sufficient to form

a belief as to the truth of the allegation that the income taxes and interest referred to therein have been paid.

Denies the allegations contained in the third sentence.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information and knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

VIII.

With respect to the allegations contained in paragraph VIII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentences.

IX.

Denies the allegations contained in paragraph IX.

X.

With respect to the allegations contained in paragraph X, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

XI.

With respect to the allegations contained in paragraph XI, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the claim for refund referred to therein speaks for itself, except admits that on October 16, 1967, the plaintiff filed a claim for refund of income taxes in the amount of \$231, plus applicable interest; allegedly paid on April 7, 1966, for its fiscal year ended June 30, 1961.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

XII.

Admits the allegations contained in paragraph XII.

COUNT II

For answer to Count II of the complaint, the defendant says:

I.

The defendant's answer to paragraph I of Count II is the same as its answers to paragraphs I through IV of Count I.

II.

(a) With respect to the allegations contained in subparagraph (a) of paragraph II, the defendant answers as follows:

Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

III.

With respect to the allegations contained in paragraph III, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the Revenue Agent's report and the statute referred to therein speak for themselves.

Denies the allegations contained in the second sentence for the reason that the adjustments referred to therein speak for themselves.

Denies the allegations contained in the third sentence.

IV.

With respect to the allegations contained in paragraph IV, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

V.

With respect to the allegations contained in paragraph V, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentences.

VI.

Denies the allegations contained in paragraph VI.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

Admits the allegations contained in the third sentence, except denies that the plaintiff is entitled to the refund claimed.

VIII.

With respect to the allegations contained in paragraph VIII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the claim for refund referred to therein speaks for itself, except admits that on October 16, 1967, the plaintiff filed a claim for refund of income taxes in the amount of \$174,478.04, plus applicable interest, allegedly paid on April 4, 1966, April 7, 1966, and July 18, 1966, for its fiscal year ended June 30, 1962.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

IX.

Admits the allegations contained in paragraph IX.

COUNT III

For answer to Count III of the complaint, the defendant says:

I.

The defendant's answer to paragraph I of Count III is the same as its answers to paragraphs I through IV of Count I.

II.

(a) With respect to the allegations contained in subparagraph (a) of paragraph II, the defendant answers as follows:
Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

(b) Denies the allegations contained in subparagraph (b) of paragraph II, except admits that in said Revenue Agent's report (dated January 10, 1966), the Revenue Agent included in the plaintiff's income for the fiscal year ended June 30, 1963, the sum of \$52,305.05 as the value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by the plaintiff from the New Orleans Bank for Cooperatives as patronage dividends.

III.

With respect to the allegations contained in paragraph III, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the Revenue Agent's report and the statute referred to therein speak for themselves.

Denies the allegations contained in the second sentence for the reason that the adjustments referred to therein speak for themselves.

Denies the allegations contained in the third sentence.

IV.

With respect to the allegations contained in paragraph IV, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

V.

With respect to the allegations contained in paragraph V, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentences.

VI.

Denies the allegations contained in paragraph VI.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

Admits the allegations contained in the third sentence, except denies that the plaintiff is entitled to the refund claimed.

VIII.

With respect to the allegation contained in paragraph VIII, the defendant answers as follows:

Denies the allegations contained in the first sentence, except admits that on October 16, 1967, the plaintiff filed a claim for refund of income taxes in the amount of \$41,422.10, plus applicable interest, allegedly paid on September 10, 1963 (with return), April 4, 1966, April 7, 1966, and July 18, 1967, for its fiscal year ended June 30, 1963.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

IX.

Admits the allegations contained in paragraph IX.

WHEREFORE, the defendant prays for judgment in its favor, for dismissal of the complaint with prejudice, for costs and such other and further relief as this Court may deem just and proper.

/s/ ROBERT E. HAUBERG
United States Attorney

In the United States District Court for the Southern District
of Mississippi, Western Division
Civil Action No. 1213

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

ANSWER

(Filed Feb. 19 1968).

Comes now the defendant, the United States of America, by its attorney, Robert E. Hauberg, United States Attorney for

the Southern District of Mississippi, and for its answer to the plaintiff's complaint herein, admits, denies and alleges as follows:

COUNT I.

For answer to Count I of the complaint, the defendant says:

I.

Admits the allegations contained in paragraph I.

II.

Denies the allegations contained in paragraph II for the reason that the complaint attacks the validity of a determination of an officer of the United States and, thus, pursuant to Rule 4(d)(4) of the Federal Rules of Civil Procedure, a copy of the summons and of the complaint must be sent by registered or certified mail to such officer.

III.

Admits the allegations contained in paragraph III, except denies that the income taxes and interest sought to be recovered by the plaintiff were erroneously or illegally assessed and wrongfully collected.

IV.

Denies the allegations contained in paragraph IV for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof, except admits that plaintiff is organized under the general corporate laws of the State of Mississippi.

V.

(a) With respect to the allegations contained in subparagraph (a) of paragraph V, the defendant answers as follows:

Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

VI.

With respect to the allegations contained in paragraph VI, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information and knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentences.

VIII.

Denies the allegations contained in paragraph VIII.

IX.

With respect to the allegations contained in paragraph IX, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

X.

With respect to the allegations contained in paragraph X, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the claim for refund referred to therein speaks for itself, except admits that on October 13, 1967, the plaintiff filed a claim for refund of income taxes in the amount of \$24,489.26, plus applicable interest, allegedly paid on April 4, 1966, and June 29, 1967, for its fiscal year ended June 30, 1961.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

XI.

Admits the allegations contained in paragraph XI.

COUNT II

For answer to Count II of the complaint, the defendant says:

I.

The defendant's answer to paragraph I of Count II is the same as its answer to paragraphs I through IV of Count I.

II.

(a) With respect to the allegations contained in subparagraph (a) of paragraph II, the defendant answers as follows:

Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

(b) Denies the allegations contained in subparagraph (b) of paragraph II, except admits that in said Revenue Agent's report (dated January 10, 1966), the Revenue Agent included in the plaintiff's income for the fiscal year ended June 30, 1962, the sum of \$27,489.40 as the value of Class C stock of the New Orleans Bank for Cooperatives, which Class C stock had been received by the plaintiff from the New Orleans Bank for Cooperatives as patronage dividends.

III.

With respect to the allegations contained in paragraph III, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

IV.

With respect to the allegations contained in paragraph IV, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentences.

V.

Denies the allegations contained in paragraph V.

VI.

With respect to the allegations contained in paragraph VI, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the claim for refund referred to therein speaks for itself, except admits that on October 13, 1967, the plaintiff filed a claim for refund of income taxes in the amount of

\$22,798.79, plus applicable interest, allegedly paid on April 4, 1966, and July 21, 1967, for its fiscal year ended June 30, 1962.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

VIII.

Admits the allegations contained in paragraph VIII.

COUNT III

For answer to Count III of the complaint, the defendant says:

I.

The defendant's answer to paragraph I of Count III is the same as its answers to paragraphs I through IV of Count I.

II.

(a) With respect to the allegations contained in subparagraph (a) of paragraph II, the defendant answers as follows:

Admits the allegations contained in the first sentence.

Denies the allegations contained in the second sentence for the reason that the income tax return and the statute referred to therein speak for themselves.

Denies the allegations contained in the third sentence, except admits that on or about March 14, 1966, an Internal Revenue Agent's report (dated January 10, 1966) was submitted to the plaintiff.

III.

With respect to the allegations contained in paragraph III, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the second and third sentences for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the fourth sentence for the reason that the statute referred to therein speaks for itself.

Denies the allegations contained in the fifth sentence.

IV.

With respect to the allegations contained in paragraph IV, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the statute referred to therein speaks for itself.

Admits the allegations contained in the second sentence.

Denies the allegations contained in the third and fourth sentence.

V.

Denies the allegations contained in paragraph V.

VI.

With respect to the allegations contained in paragraph VI, the defendant answers as follows:

Denies the allegations contained in the first sentence for the reason that the defendant is presently without information or knowledge sufficient to form a belief as to the truth thereof.

Denies the allegations contained in the second sentence.

VII.

With respect to the allegations contained in paragraph VII, the defendant answers as follows:

Denies the allegations contained in the first sentence, except admits that on October 13, 1967, the plaintiff filed a claim for refund of income taxes in the amount of \$21,113.87, plus applicable interest, allegedly paid on April 4, 1966, and July 21, 1967, for its fiscal year ended June 30, 1963.

Admits the allegations contained in the second sentence, except denies each and every allegation contained in the claim for refund referred to therein unless specifically admitted herein.

VIII.

Admits the allegations contained in paragraph VIII.

WHEREFORE, the defendant prays for judgment in its favor, for dismissal of the complaint with prejudice, for costs and such other relief as this Court may deem just and proper.

/s/ ROBERT E. HAUBERG,
United States Attorney

In the United States District Court for the Southern District
of Mississippi, Western Division

Civil Action No. 1214

COASTAL CHEMICAL CORPORATION, PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

STIPULATION AS TO FACTS AND DOCUMENTS

(Filed Nov. 6, 1968)

It is hereby stipulated by the parties to this action, by and through their respective counsel, that, for purposes of this action only, the following facts are true and that the exhibits attached hereto are true copies of genuine original documents, any or all of which may be introduced as evidence at the trial hereof, subject only to pertinent objections as to competency, relevancy and materially. Each party, however, expressly reserves the right of offer at the trial such other and further evidence as is not inconsistent with the facts stipulated herein.

1. This is a civil action, instituted by the plaintiff, Coastal Chemical Corporation, against the defendant, the United States of America, for the recovery of \$263,518.70 in income taxes and interest assessed against and collected from the plaintiff by the defendant for the fiscal years ended June 30, 1961, 1962 and 1963.

2. The pleadings raising the issues to be resolved are the complaint and the answer.

3. Federal jurisdiction is invoked herein under 28 U.S.C., Section 1340 and/or 28 U.S.C., Section 1346(a)(1).

4. At all times material herein, the plaintiff

(a) was a corporation organized under the laws of Mississippi with its domicile and principal place of business in Yazoo City, Yazoo County, Mississippi.

(b) was a cooperative association as defined in the Agricultural Marketing Act, as amended;

(c) was subject to the tax imposed by 26 U.S.C., Section 11 (The plaintiff was not, at any time material herein, a farmers' cooperative organization as described in 26 U.S.C., Section 521 (b)(1).)

(d) kept its books and records on the accrual method of accounting and on a July 1 to June 30 fiscal year basis.

5. The plaintiff timely filed its federal income tax returns (Forms 1120) for the fiscal years ended June 30, 1957, 1958, 1959, 1960, 1961, 1962, and 1963, with the District Director of Internal Revenue for the State of Mississippi. True copies of those returns are attached hereto as Exhibits 1-A, 1-B, 1-C, 1-D, 1-E, 1-F, and 1-G, respectively.

7. In its federal income tax return for the fiscal year ended June 30, 1963, the plaintiff reported a tax liability (after investment credit) of \$63,722.24 which was paid prior to the filing of the return.

8. During each of the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962 and 1963, the plaintiff was a borrower from the New Orleans Bank for Cooperatives. As such borrower during each of those years, it was required under 12 U.S.C., Section 1134d(a)(3) to invest quarterly in the Class C stock of said bank an amount equal to 15 percent of the amount of interest payable by it to the bank during the calendar quarter on its loans. The 15 percent rate was authorized by 12 U.S.C., Section 1134d(a)(3) and was prescribed by the board of directors of the bank with the approval of the Farm Credit Administration. Pursuant to said investment requirement, the plaintiff purchased the Class C stock of the New Orleans Bank for Cooperatives referred to in paragraph 16 hereof. In its federal income tax returns, the plaintiff claimed \$99.00 of each \$100.00 thus invested as a deduction in each of the fiscal years ended June 30, 1958, 1959, 1960 and 1961 under the heading "Other Deductions—Interest on facility loan," and in each of the fiscal years ended June 30, 1962 and 1963 under the heading "Interest." Following the audit of the plaintiff's income tax returns, such deductions were disallowed. Such disallowances form the basis of the issues specified in paragraph 31(a) hereof:

9. For each of the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962 and 1963, the New Orleans Bank for Cooperatives declared a patronage refund to the plaintiff in accordance with 12 U.S.C., Section 1134l(b). Each such patronage refund was declared in the form of Class C stock having a par value of \$100.00 per share. The total par value of the patronage refund so declared for each such fiscal year is set out in paragraph 19 hereof. Plaintiff did not include in the income reported in its federal income tax returns, \$99.00 per share of the par

value of such stock thus declared to it. For purposes of federal income taxation, in each year in which a patronage refund was declared to it, the plaintiff reduced its interest expense by \$1.00 for each share of Class C stock making up such patronage refund. Following the audit of the plaintiff's income tax returns, \$99.00 of the par value of such stock was included in the plaintiff's income. Such conclusions form the basis of the issue specified in paragraph 31 (b) hereof.

10. In applying for loans from the New Orleans Bank for Cooperatives, the plaintiff filed with said bank documents containing substantially the information called for in Exhibits 1a, 1b, 1c, 1d, 1e and 3 of the Manual for Banks for Cooperatives, a true copy of which is attached hereto as Exhibit 17.

11. In connection with loans obtained by the plaintiff from the New Orleans Bank for Cooperatives, the plaintiff executed loan agreements and installment notes. True copies of a loan agreement and installment note typical of the ones referred to are attached hereto as Exhibits 5-A and 5-B, respectively.

12. At or near the end of each calendar quarter during which the New Orleans Bank for Cooperatives had a loan outstanding to the plaintiff, the bank mailed to the plaintiff a notice of the amount of interest that was due on the plaintiff's debt and the amount of the Class C stock of the bank the plaintiff was required to purchase at par value (pursuant to the loan documents which contain the requirements of the regulations and the statute) for such calendar quarter. True copies of notices typical of the one referred to are attached hereto as Exhibits 6-A and 6-B. Exhibit 6-B is as follows:

New Orleans Bank for Cooperatives, New Orleans, La.	Loan No.	Item		Amount Due
Interest:				
Notice of payments due, date, June 27, 1961.....	{	From	To	Rate
	F-2128	4/1/61	6/30/61.	5 \$45,093. 15
Prompt remittance of the amount due payable at par in New Orleans will be appreciated.	F-2239	-----	-----	5 5,349. 32
C stock subscription.....				7,566. 37
Coastal Chemical Corpora- tion, Box 563, Yazoo City, Mississippi:				
Principal.....				
Other.....				
Total.....				58,008. 84

13. The board of directors of the New Orleans Bank for Cooperatives adopted a resolution on December 15, 1955, wherein it was provided that no certificate evidencing ownership of Class C stock in the bank should be issued (see Exhibit 10-C). The bank has never issued Class C stock certificates. However, the owner of such stock was entitled to have its ownership of such stock, as reflected by the books of the bank, confirmed in writing by the bank at any time upon request. Furthermore, the New Orleans Bank for Cooperatives mailed to each owner of its Class C stock as soon as practicable following the end of each fiscal year a statement setting forth the amount of such stock that was owned by such owner at the beginning and end of each such fiscal year. A true copy of a statement typical of the one referred to is attached hereto as Exhibit 7.

14. Exhibit 16 to the Manual for Banks for Cooperatives (which manual is attached hereto as Exhibit 17) consists of the form of Class C stock certificate approved by the Farm Credit Administration for issuance by banks for cooperatives.

15. During the fiscal years ended June 30, 1957, 1958, 1959, 1960, 1961, 1962 and 1963, the plaintiff purchased 2,118,9968 shares of the Class C stock of the New Orleans Bank for Cooperatives paying therefor \$100 per share (pursuant to the loan documents which contain the requirements of the regulations and the statute).

16. The following chart shows the years during which the plaintiff purchased the Class C stock of the New Orleans Bank for Cooperatives (referred to in paragraph 15); the portion of the amount paid for said stock that was deducted each year for federal income tax purposes; the portion of the amount paid for said stock that was added each year to previously reported similar investments in Class C stock; and the cumulative balance each year of the amounts reported as such investments in such Class C stock:

FYE 6-30	Par Value of Class C Stock Purchased as Above	Portion of Purchase Price of Class C Stock Deducted Under Interest in Returns	Portion of Amount Paid for Class C Stock Reported as Investments	
			Yearly Addition	Cumulative Balance
1957-----	\$100. 00		\$100. 00	\$100. 00
1958-----	11, 788. 19	\$11, 670. 19	118. 00	218. 00
1959-----	33, 956. 20	33, 617. 20	339. 00	557. 00
1960-----	47, 119. 23	46, 646. 23	473. 00	1, 030. 00
1961-----	41, 712. 88	41, 295. 88	417. 00	1, 447. 00
1962-----	35, 072. 16	34, 721. 16	351. 00	1, 798. 00
1963-----	42, 151. 02	41, 730. 02	421. 00	2, 219. 00

17. With respect to the chart made a part of paragraph 16:

(a) The amounts listed as having been deducted in the fiscal years ended June 30, 1958, 1959, 1960 and 1961 were deducted in the schedules of income and expense of the plaintiff's federal income tax returns for the fiscal years ended June 30, 1958, 1959, 1960 and 1961, respectively, as parts of the amounts deducted under the heading "Other Deductions-Interest on facility loan." The amounts listed as having been deducted in the fiscal years ended June 30, 1962 and 1963, were deducted on page 1 (Item 18) of the plaintiff's federal income tax returns for the fiscal years ended June 30, 1962 and 1963, respectively, as parts of the amounts deducted under the heading "Interest." The one qualifying share purchased in 1957 prior to obtaining any loan was treated as an investment. Thereafter, all deductions were on the basis of \$99.00 per share.

(b) Each amount listed as a yearly addition to Class C stock reported as an investment represents the difference between the amount paid for Class C stock purchased by the

plaintiff during the year specified and the amount of such payment as was deducted as interest for such year.

(c) Each amount listed as a cumulative balance for a particular fiscal year is reported under the heading "Investments" or "Other investments" in the balance sheet of the plaintiff's federal income tax return for such year.

(d) Where the shares of stock (including fractional shares) are listed in terms of par value, the number of shares involved may be determined by dividing such amounts by \$100, the par value of the stock per share.

18. The amounts paid by the plaintiff (pursuant to the loan documents which contain the requirements of the regulations and the statute) for the Class C stock of the New Orleans Bank for Cooperatives were entered on the books of said bank as "INVESTMENT IN C STOCK (INTEREST OVERRIDE)," except the cost of the first share purchased was entered as a "QUALIFYING SHARE." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives which reflects, *inter alia*, the plaintiff's investment in Class C stock of such bank is attached hereto as *Exhibit 2*.

19. The New Orleans Bank for Cooperatives declared to the plaintiff a patronage refund, based upon interest earned on loans to plaintiff, in the form of Class C stock for each of the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962 and 1963. The par value of the Class C stock declared for each such year as a patronage refund to the plaintiff was as follows:

FYE 6-30:	Class C Stock Par Value
1958 -----	\$14,345.04
1959 -----	47,361.32
1960 -----	51,689.59
1961 -----	60,541.52
1962 -----	52,305.05
1963 -----	63,067.29

On or about July 15 succeeding the end of each fiscal year, the bank declared patronage refunds for the preceding fiscal year based upon interest earned during such preceding fiscal year on loans to the plaintiff and on or about such date notified the plaintiff of the amount of such patronage refunds. (See Exhibit 7.) The plaintiff entered such patronage refunds upon its records and reported them in its federal income tax returns in the fiscal year in which it received such notice, as follows:

FYE 6-30	Par Value of Class C Stock Declared as Patronage Refund	Amount of Patronage Refund Entered upon Plaintiff's Records and Reported as Investment	
		Yearly Addition	Cumulative Balance
1959.....	\$14,345.04	\$143.00	\$143.00
1960.....	47,361.32	474.00	617.00
1961.....	51,689.59	516.00	1,133.00
1962.....	60,541.52	605.00	1,738.00
1963.....	52,305.05	523.00	2,261.00
1964.....	63,067.29	630.00	2,891.00

20. The par value of the Class C stock of the New Orleans Bank for Cooperatives which was declared as a patronage refund to the plaintiff for each year was entered on the books of said bank as "PATRONAGE REFUND—C STOCK." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives whereon the plaintiff's Class C stock patronage refunds were recorded is attached hereto as Exhibit 2.

21. A part of the surplus of the New Orleans Bank for Cooperatives for each of the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962 and 1963 was allocated to the plaintiff as follows:

FYE 6-30:	Amount Allocated
1958	\$6,781.42
1959	20,947.65
1960	22,855.55
1961	26,875.13
1962	23,370.87
1963	26,918.00

22. The amounts of the surplus of the New Orleans Bank for Cooperatives which were allocated to the plaintiff for each year were entered on the books of said bank as "PATRONAGE REFUND—ALLOCATED SURPLUS." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives whereon the surplus allocated to the plaintiff was recorded is attached hereto as Exhibit 2. Said bank did not notify the plaintiff in writing of the amount of surplus thus allocated to plaintiff for any year. The bank has never distributed any portion of the surplus so allocated as Class C stock.

23. The plaintiff did not enter upon its records nor include in its federal income tax returns any part of the surplus allocated to it by the New Orleans Bank for Cooperatives.

24. The federal income tax returns filed by the plaintiff for the fiscal years ended June 30, 1957, 1958, 1959, 1960, 1961, 1962, and 1963 were audited by an Internal Revenue Agent of the Internal Revenue Service. In connection with that audit, the Internal Revenue Agent prepared a report of his findings, dated January 10, 1966, and therein proposed, *inter alia*, (a) that the portion of the amount paid by the plaintiff (pursuant to the loan documents which contain the requirements of the regulations and the statute) for Class C stock of the New Orleans Bank for Cooperatives which the plaintiff had deducted in each of its federal income tax returns for the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962 and 1963 be disallowed and (b) that the par value of the Class C stock declared to the plaintiff as patronage refund for each of the fiscal years ended June 30, 1958, 1959, 1960, 1961 and 1962, to the extent not reported as investments, be included as income in the plaintiff's federal income tax return for the next succeeding year, respectively. A true copy of the report of the Internal Revenue Agent, dated January 10, 1966, is attached hereto as Exhibit 3.

(a) The amount listed as additional income for the fiscal years ended June 30, 1959, 1960, 1961, 1962 and 1963, include the par value of the Class C stock listed in the second chart in paragraph 19 as declared to the plaintiff as patronage refunds by the New Orleans Bank for Cooperatives in the fiscal years ended June 30, 1959, 1960, 1961, 1962 and 1963, respectively. Also, for the fiscal years ended June 30, 1958, 1959, 1960, 1961, 1962, and 1963, the amounts listed as additional income include the net amounts of the par value of the Class C stock purchased from the New Orleans Bank for Cooperatives by the plaintiff (pursuant to the loan documents which contain the requirements of the regulations and the statute) which are listed in the following chart as charged to interest expense by the plaintiff in such years respectively:

FYE 6-30	Par Value of C Stock Purchased	Portions of Par Value of C Stock Purchased		Amounts of Patronage Refunds Reported as Investments (By Decreasing Interest Expense)	Net Amounts Charged to Interest Expense
		Reported as Investments	Charged as Expense		
1958-----	\$11,788.19	\$118.00	\$11,670.19	-----	\$11,670.19
1959-----	33,956.20	339.00	33,617.20	\$143.00	33,474.20
1960-----	47,119.23	473.00	46,646.23	747.00	46,172.23
1961-----	41,712.88	417.00	41,295.88	516.00	40,779.88
1962-----	35,072.16	351.00	34,721.16	605.00	34,116.16
1963-----	42,151.02	421.00	41,730.02	523.00	41,207.02

(b) The effect of including the "Net Amounts Charged to Interest Expense" in the plaintiff's income was to deny to the plaintiff deductions of \$99.00 per share that it claimed with respect to the Class C stock it purchased and to treat such amounts as capital expenditures.

(c) Ninety-nine dollars of the par value of the Class C stock declared to the plaintiff as patronage refunds were not included as income in the plaintiff's federal income tax returns. One dollar per share was carried as a reduction of interest expense and as an asset (investment).

27. At the direction of the Commissioner of Internal Revenue, tax deficiencies were assessed against the plaintiff for each of the fiscal years ended June 30, 1961, 1962 and 1963, in the total amounts of \$231, \$254,268.94 and \$120,180.78, respectively. The assessments were based upon the taxable income proposed by the Internal Revenue Agent except that certain patronage refund deductions, not involved herein, were allowed the plaintiff for the fiscal years ended June 30, 1962 and 1963. A true copy of the Audit Statement whereon such patronage refund deductions were allowed is attached hereto as Exhibit 4.

29. On October 16, 1967, the plaintiff timely filed the inclusion in its income of the \$99.00 per share of the par value of the patronage refunds declared to it in the form of Class C stock by the New Orleans Bank for Cooperatives.

30. The claims for refund (referred to in paragraph 29) were disallowed and the plaintiff was notified of such disallow-

ance by certified letters dated December 13, 1967. Thereafter, this action was timely instituted.

31. The following issues are to be litigated at the trial:

(a) Whether for purposes of federal income taxation the plaintiff was entitled to deduct from its gross income (as the plaintiff contends in its complaint) any part (and, if so, the amount) of the par value of the Class C stock it purchased (pursuant to the loan documents which contain the requirements of the regulations and the statute) from the New Orleans Bank for Cooperatives during the fiscal years ending June 30, 1958, 1959, 1960, 1961, 1962 and 1963. See particularly paragraph 8 hereof.

(b) Whether any part (and, if so, the amount) of the par value of the patronage refunds declared to the plaintiff in the form of Class C stock by the New Orleans Bank for Cooperatives in the fiscal years ended June 30, 1959, 1960, 1961, 1962 and 1963 was includable in the plaintiff's gross income for purposes of federal income taxation. See, particularly paragraph 9 hereof.

32. On May 20, 1959, the board of directors of the New Orleans Bank of Cooperatives approved as a goal a schedule for Class A stock retirement, such schedule being a general objective. A true and exact excerpt from the minutes of the regular meeting of the board of directors of the New Orleans Bank for Cooperatives reflecting such approval and a true copy of the retirement schedule thus proposed by the bank (captioned N.O.B.C. Program of Class A Stock Retirement) are attached hereto as Exhibit 8.

33. The board of directors of the New Orleans Bank for Cooperatives has never determined that the capital stock of said bank was impaired.

34. The New Orleans Bank for Cooperatives has never established a contingency reserve within the meaning of 12 U.S.C., Section 11341(a)(4) and has never received a deposit to an established guaranty fund in lieu of a purchase of its Class B or Class C stock.

35. Attached hereto as Exhibits 9-A, 9-B, 9-C and 9-D, respectively, are true copies of the minutes of the regular monthly meetings of the board of directors of the New Orleans Bank for Cooperatives held on January 20, 1960; April 21, 1960; May 19, 1960; and June 22, 1960. Attached to and made a part of the minutes of May 19, 1960 (Exhibit

9-C) and June 22, 1960 (Exhibit 9-D) are true copies of parts of monthly reports to the board of directors for the months of April and May, 1960, respectively, which were prepaid and kept in the regular course of the business of the New Orleans Bank for Cooperatives. Attached hereto as Exhibit 9-E is a statement of Class C stock and allocated surplus applied in liquidations January 1, 1956 to June 30, 1963. Exhibit 9-E, which is attached hereto and which is to be considered a part hereof, shows, *inter alia*, the par value of Class C stock of the New Orleans Bank for Cooperatives which was owned by defaulting debtors of said bank and the amounts of the surplus of said bank which had been allocated to said defaulting debtors, which was applied to the debts of such debtors when they went out of business and were liquidated.

36. Attached hereto as Exhibits 10-A, 10-B, 10-C and 10-D are true copies of resolutions duly adopted by the board of directors of the New Orleans Bank for Cooperatives and kept by said bank in the regular course of its business.

37. Attached hereto as Exhibit 11 is a true and exact excerpt from the minutes of the regular meeting of the board of directors of the New Orleans Bank for Cooperatives held on November 15, 1961.

38. Attached hereto as Exhibits 12-A, 12-B and 12-C, respectively, are true copies of Reports to Stockholders for the fiscal years ended June 30, 1961, 1962 and 1963 which were prepared and issued by the New Orleans Bank of Cooperatives in the regular course of its business.

39. Attached hereto as Exhibits 13-A, 13-B, 13-C and 13-D, respectively, are true copies of Reports to the Board of Directors of the New Orleans Bank for Cooperatives for the fiscal years ended June 30, 1960, 1961, 1962 and 1963, which were prepared and kept by the New Orleans Bank for Cooperatives in the regular course of its business.

40. The New Orleans Bank for Cooperatives, which has its principal office in New Orleans, Louisiana, was organized and chartered pursuant to the provisions of 12 U.S.C., Section 1134.

43. Attached hereto as Schedule A, which is to be considered a part hereof, is a chart which shows the net worth of the New Orleans Bank for Cooperatives as of the end of each of its fiscal years ended June 30, 1956, 1957, 1958, 1959, 1960, 1961, 1962 and 1963.

44. Attached hereto as Schedule B, which is to be considered a part hereof, is a chart which shows the par value of Class C stock of the New Orleans Bank for Cooperatives and amounts of surplus allocated to patrons by said bank which were transferred on the dates indicated therein.

45. Attached hereto as Schedule C, which is to be considered a part hereof, is a chart which shows, with respect to each of the fiscal years ended June 30, 1957, 1958, 1959, 1960, 1961, 1962 and 1963, the amount of Class A stock retired at par value; the sum of the par value of all Class C stock issued; the amount of surplus allocated to patrons; the amount of franchise tax paid; the amount of cash dividends paid on Class B stock; and the par value of Class C stock declared as patronage refunds, by the New Orleans Bank for Cooperatives.

46. Attached hereto as Schedule D, which is to be considered a part hereof, is a chart which shows the amount of loans the New Orleans Bank for Cooperatives had outstanding, less outstanding participation certificates; the par value of the several classes of capital stock the said bank had outstanding; and the amount of surplus the said bank had reserved and had allocated to patrons, as of the end of each of the fiscal years ended June 30, 1956, 1957, 1958, 1959, 1960, 1961, 1962 and 1963.

47. Attached hereto as Schedule E, which is to be considered a part hereof, is a chart which shows the par value of the Class C stock the New Orleans Bank for Cooperatives had outstanding, the amount of surplus the said bank had allocated to patrons, and the totals thereof, respectively, as of the end of each of the fiscal years ended June 30, 1956, 1957, 1958, 1959, 1960, 1961, 1962 and 1963.

48. Attached hereto as Schedule F, which is to be considered a part hereof, is a chart which shows the amount of loans the Thirteen Banks for Cooperatives had outstanding, less outstanding participation certificates, the par value of the several classes of capital stock the said banks had outstanding; and the amount of surplus the said banks had reserved and had allocated to patrons, as of the end of each of the fiscal years ended June 30, 1956, 1957, 1958, 1959, 1960, 1961, 1962 and 1963.

49. The New Orleans Bank for Cooperatives, at all times material herein, was operated under the supervision of the Farm Credit Administration, an independent agency in the executive branch of the Government. The Farm Credit Admin-

istration was authorized by law to make rules and regulations under the Farm Credit Act of 1933 and Acts amendatory thereto. (12 U.S.C., Section 665.) Attached hereto as Exhibit 17 is an official publication of the Farm Credit Administration entitled Manual for Banks for Cooperatives (including copies of all amendments thereto through June 30, 1963), which includes regulations of the Farm Credit Administration governing the operations of banks for cooperatives; certain statements of policy relating to their activities, various basic forms and procedures; and selected informational material assembled for convenient reference.

50. Attached hereto as Exhibits 18-A and 18-B, respectively, are official publications of the Farm Credit Administration entitled:

(a) Banks for Cooperatives, a quarter of a century of progress.

(b) Banks for Cooperatives, how they operate.

51. Attached hereto as Exhibits 19-A, 19-B, 19-C, 19-D, 19-E, 19-F, 19-G and 19-H, respectively, are true copies of the Annual Reports of the Farm Credit Administration to Congress for the fiscal years ended June 30, 1956, 1957, 1958, 1959, 1960, 1961, 1962 and 1963. These Annual Reports are official publications of the Farm Credit Administration and were prepared pursuant to Acts of Congress (e.g., 12 U.S.C. Section 636(e)).

52. Attached hereto as Exhibit 21 are true copies of nine letters, dated December 8, 1955; October 31, 1956; August 5, 1957; July 21, 1958; July 22, 1959; July 21, 1960; July 21, 1961; July 26, 1962 and July 17, 1963, from the officials of the United States Treasury Department to the Governor of the Farm Credit Administration, in each of which, pursuant to 12 U.S.C., Section 1134l(a)(3), the average rate of interest on all public issues of public debt obligations of the United States issued during the fiscal year most recently ending is certified.

Stipulated and agreed to by:

/s/ JOHN C. SATTERFIELD
Attorney for Plaintiff

ROBERT E. HAUBERG
United States Attorney
Attorney for defendant

Date: 11-6-68

By: /s/ Jack D. Warren
JACK D. WARREN
Attorney, Tax Division

Department of Justice, Washington, D.C. 20530

Date: 11-6-68

(All of the Exhibits attached to the foregoing instrument
will be sent to the Court in original form.)

SCHEDULE A.—New Orleans Bank for Cooperatives, schedule of net worth FYE June 30, 1956 through FYE June 30, 1963

	FYE 6-30-56	FYE 6-30-57	FYE 6-30-58	FYE 6-30-59	FYE 6-30-60	FYE 6-30-61	FYE 6-30-62	FYE 6-30-63
A stock.....	\$6,928,100.00	\$6,744,800.00	\$6,817,000.00	\$6,270,000.00	\$6,970,000.00	\$6,620,000.00	\$6,270,000	\$4,880,000
B stock.....	360,400.07	364,722.06	360,666.29	367,819.74	406,431.14	403,747.34	402,119	369,662
C stock.....	86,880.66	287,864.46	537,524.81	881,454.21	1,291,082.56	1,729,282.16	2,188,366	2,681,548
Old stock.....	201,846.26	135,804.19	74,940.49	44,026.53				
Subtotal.....	\$7,576,966.98	\$7,536,190.60	\$7,490,131.59	\$7,653,300.48	\$7,666,483.70	\$7,753,009.50	\$7,830,475	\$7,901,110
Surplus—reserved.....	3,627,888.15	3,627,888.15	3,627,888.15	3,627,888.15	3,627,888.15	3,627,888.15	3,627,888	3,627,888
Surplus—allocated to patrons.....	27,760.84	94,461.09	163,324.79	264,469.64	346,274.03	463,454.06	577,968	711,449
Net worth.....	\$11,223,644.97	\$11,257,539.93	\$11,281,344.53	\$11,435,668.77	\$11,642,645.88	\$11,844,362.33	\$12,036,321	\$12,300,447

SCHEDULE B.—New Orleans Bank for Cooperatives, schedule of Class C stock and allocated surplus transfers September 30, 1959—June 12, 1963

Date of Transfer	Transferred From	Transferred To	C Stock —Par Value—	Surplus Allocated to Patrons
9-20-59	Holmes County Grain Elevator Association, Lexington, Mississippi.	Holmes County Cooperative, Lexington, Mississippi.	\$1,826.58	\$446.22
6-30-61	Louisiana-Mississippi Milk Prod. Assn., Poplar- ville, Mississippi. American Rice Growers Cooperative Assn., Lake Charles, Louisiana.	Gulf Milk Association, Inc., Franklinton, Louisiana. MFC Services, La. Rice Grbwers, to Roanoke Rice Mill.	5,802.69	1,571.52
6-12-63	Rising Sun Gin Company, Greenwood, Missis- sippi.	Assigned to C. S. Whittington-----	3,866.61	960.23

SCHEDULE C.—New Orleans Bank for Cooperatives, schedule of Class A stock retired (par value); par value of all Class C stock issued; surplus allocated to patrons; franchise tax paid; cash dividends paid on Class B stock; and par value of Class C stock declared as patronage refunds, FYE June 30, 1957 through June 30, 1963

	FYE 6-30	Class A Stock Retired—Par Value	Total Class C Stock Issued— Par Value	Surplus Allocated to Patrons	Franchise Tax Paid	Cash Dividends Paid on Class B Stock	Class C Stock Declared as Patronage Refunds—Par Value
1957	-----	\$181,300	\$201,274	\$66,700	\$48,590	\$10,942	\$140,569
1958	-----	229,800	249,661	68,864	50,101	10,820	145,670
1959	-----	247,000	343,929	91,145	56,627	10,735	206,073
1960	-----	300,000	409,599	93,804	60,543	11,826	221,644
1961	-----	350,000	438,209	115,181	74,507	12,112	261,107
1962	-----	350,000	429,094	114,503	75,233	9,063	256,409
1963	-----	390,000	523,192	113,491	75,724	11,987	312,759

SCHEDULE D.—New Orleans Bank for Cooperatives, Schedule of loans outstanding, less outstanding participation certificates; capital stock outstanding; surplus reserved; and surplus allocated to patrons, FYE June 30, 1966 through FYE June 30, 1963

	FYE 6-30-63	FYE 6-30-62	FYE 6-30-61	FYE 6-30-60	FYE 6-30-59	FYE 6-30-58	FYE 6-30-57	FYE 6-30-56
Loans to cooperative associations outstanding.....	\$27,939,969	\$19,627,247	\$20,334,247	\$19,881,001	\$21,523,383	\$17,668,177	\$12,937,969	\$9,513,442
Less participation certificates outstanding.....	7,170,320	3,082,811	2,221,723	3,110,193	4,665,768	332,600	601,800	751,900
Total.....	20,769,639	16,544,436	18,112,524	16,770,808	17,162,625	17,335,577	12,336,169	8,761,542
Capital Stock:								
Class A.....	4,880,000	5,270,000	5,620,000	5,970,000	6,270,000	6,517,000	6,744,809	6,928,100
Class B.....	399,862	402,119	403,747	405,431	357,820	360,666	364,722	360,460
Class C.....	2,681,548	2,158,366	1,729,262	1,291,063	881,454	537,525	287,895	98,500
Other (Old stock).....					44,026	74,941	135,804	201,846
Total.....	7,961,110	7,830,475	7,753,009	7,666,494	7,553,300	7,490,132	7,534,191	7,576,906
Surplus reserved.....	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888
Surplus allocated to patrons.....	711,449	577,958	463,455	348,274	254,470	163,325	94,461	27,761

SCHEDULE E.—New Orleans Bank for Cooperatives, schedule of Class C stock outstanding and surplus allocated to patrons FYE June 30, 1966 through FYE June 30, 1963

	FYE 6-30-63	FYE 6-30-62	FYE 6-30-61	FYE 6-30-60	FYE 6-30-59	FYE 6-30-58	FYE 6-30-57	FYE 6-30-56
Class C Stock.....	\$2,681,548	\$2,158,358	\$1,729,262	\$1,291,053	\$881,454	\$537,525	\$287,865	\$86,590
Surplus allocated to patrons.....	711,449	577,958	463,455	348,274	254,470	163,325	94,461	27,761
Total.....	\$3,392,997	\$2,736,314	\$2,192,717	\$1,639,327	\$1,135,924	\$700,850	\$382,326	\$114,351

SCHEDULE F.—The Thirteen Banks for Cooperatives, schedule of loans outstanding less outstanding participation certificates; capital stock outstanding; surplus reserved; and surplus allocated to patrons, FYE June 30, 1958 through FYE June 30, 1963

	FYE 6-30-53	FYE 6-30-52	FYE 6-30-51	FYE 6-30-50	FYE 6-30-49	FYE 6-30-48	FYE 6-30-47	FYE 6-30-46
Loans to cooperative associations outstanding.....	\$700,562,049	\$692,362,803	\$694,548,829	\$650,712,891	\$526,880,724	\$408,287,152	\$384,328,803	\$349,074,139
Less participation certificates outstanding.....	13,061	18,367					2,970	6,538
Total.....	\$700,548,988	\$692,344,436	\$694,548,829	\$650,712,891	\$526,880,724	\$408,287,152	\$384,325,833	\$349,067,607
Capital stock and guaranty fund:								
Class A.....	80,911,100	94,837,500	108,817,000	118,286,900	126,330,800	134,798,700	141,672,360	147,300,000
Class B.....	11,229,389	12,235,953	13,186,012	14,009,049	14,598,439	14,977,322	15,399,393	15,607,675
Class C.....	68,830,284	54,663,776	42,407,410	31,028,529	23,214,786	15,303,640	8,703,326	2,820,037
Other.....	52,300	89,500	198,400	283,443	412,367	520,474	1,229,604	2,254,208
Total.....	\$161,023,073	\$167,826,769	\$162,608,822	\$164,176,521	\$164,535,512	\$165,659,136	\$168,944,613	\$168,042,520
Surplus reserved.....	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198
Surplus allocated to patrons.....	19,640,915	17,542,510	13,600,203	10,049,081	7,720,210	5,077,085	2,985,071	977,000

In the United States District Court for the Southern District
of Mississippi Western Division

Civil Action No. 1213

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

STIPULATION AS TO FACTS AND DOCUMENTS

(Filed Nov. 6, 1968)

It is hereby stipulated by the parties to this action, by and through their respective counsel, that, for purposes of this action only, the following facts are true and that the exhibits attached hereto are true copies of genuine original documents, any or all of which may be introduced as evidence at the trial hereof, subject only to pertinent objections as to competency, relevancy and materiality. Each party, however, expressly reserves the right to offer at the trial such other and further evidence as is not inconsistent with the facts stipulated herein.

1. This is a civil action instituted by the plaintiff, Mississippi Chemical Corporation, against the defendant, the United States of America, for the recovery of \$85,299.51 in income taxes and interest assessed against and collected from the plaintiff by the defendant for the fiscal years ended June 30, 1961, 1962 and 1963.

2. The pleadings raising the issues to be resolved are the complaint and the answer.

3. Federal jurisdiction is invoked herein under 28 U.S.C., Section 1340 and/or 28 U.S.C., Section 1346(a)(1).

4. At all times material herein, the plaintiff—

(a) was a corporation organized under the laws of Mississippi with its domicile and principal place of business in Yazoo City, Yazoo County, Mississippi.

(b) was a cooperative association as defined in the Agricultural Marketing Act, as amended;

(c) was subject to the tax imposed by 26 U.S.C., Section 11; (The plaintiff was not, at any time material herein, a farmers' cooperative organization as described in 26 U.S.C., Section 521(b)(1).)

(d) kept its books and records on the accrual method of accounting and on a July 1 to June 30 fiscal year basis.

5. The plaintiff timely filed its federal income tax returns (Forms 1120) for the fiscal years ended June 30, 1961, 1962 and 1963, with the District Director of Internal Revenue for the State of Mississippi. True copies of those returns are attached hereto as Exhibits 30-A, 30-B and 30-C, respectively. The plaintiff timely filed an amended federal income tax return (Form 1120) for the fiscal year ended June 30, 1962, with the District Director of Internal Revenue for the State of Mississippi. A true copy of said amended return is attached to Exhibit 30-B as a part thereof.

6. The following chart shows the net income, including long-term capital gains; the special deductions; the taxable income reported by the plaintiff in each of its federal income tax returns for the fiscal years ended June 30, 1961, 1962 and 1963:

FYE 6-30	Net Income, Including Long-Term Capital Gains	Special Deductions	Taxable Income
1961-----	\$169, 102. 10	(\$56, 269. 53)	\$112, 832. 57
1962-----	*606, 184. 91	-----	606, 184. 91
1963-----	524, 899. 24	(7, 323. 41)	517, 575. 83
	\$1, 300, 186. 25	(\$63, 592. 94)	\$1, 236, 593. 31

*Per amended return.

7. In its federal income tax returns for the fiscal years ended June 30, 1961, 1962 and 1963, the plaintiff reported tax liabilities of \$46,548.07, \$297,812.26 (per amended return) and \$204,016.71 (after investment credit), respectively, which it paid at or before the time such returns were filed.

8. During each of the fiscal years ended June 30, 1961, 1962 and 1963, the plaintiff was a borrower from the New Orleans Bank for Cooperatives. As such borrower, it was required under 12 U.S.C., Section 1134d(a)(3) to invest quarterly in the Class C stock of said bank an amount equal to 15 percent of the amount of interest payable by it on its loans. The 15 percent rate was authorized by 12 U.S.C., Section 1134d(a)(3) and was prescribed by the board of directors of the bank with the approval of the Farm Credit Administration. Pursuant to said in-

vestment requirement, the plaintiff purchased the Class C stock of the New Orleans Bank for Cooperatives referred to in paragraph 16 hereof. In its federal income tax returns, the plaintiff claimed \$99.00 of each \$100.00 thus invested as a deduction in the fiscal year ended June 30, 1961 under the heading "Interest Expense: on Facility Loan, etc.", and in each of the fiscal years ended June 30, 1962 and 1963 under the heading "Interest." Following the audit of the plaintiff's income tax returns, such deductions were disallowed. Such disallowances form the basis of the issue specified in paragraph 31(a) hereof.

9. For each of the fiscal years ended June 30, 1960, 1961 and 1962, the New Orleans Bank for Cooperatives declared a patronage refund to the plaintiff in accordance with 12 U.S.C., Section 1134l(b). Each such patronage refund was declared in the form of Class C stock having a par value of \$100.00 per share. The total par value of the patronage refund so declared for each such fiscal year is set out in paragraph 19 hereof. The plaintiff did not include in the income reported in its federal income tax returns for the fiscal years ended June 30, 1961, 1962 and 1963, \$99.00 per share of the par value of such stock thus declared to it. For purposes of federal income taxation, in each year in which a patronage refund was declared to it, the plaintiff reduced its interest expense by \$1.00 for each share of Class C stock making up such patronage refund. Following the audit of the plaintiff's income tax returns, \$99.00 of the par value of such stock was included in the plaintiff's income. Such inclusions form the basis of the issue specified in paragraph 31(b) hereof.

10. In applying for loans from the New Orleans Bank for Cooperatives, the plaintiff filed with said bank documents containing substantially the information called for in Exhibits 1a, 1b, 1c, 1d, 1e and 3 of the Manual for Banks for Cooperatives, a true copy of which is attached as Exhibit 17 to the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.).

11. In connection with loans obtained by the plaintiff from the New Orleans Bank for Cooperatives, the plaintiff executed loan agreements and installment notes. True copies of a loan agreement and installment note typical of the ones referred to are attached as Exhibits 5-A and 5-B, respectively, to the Stipulation As To Facts and Documents filed on even date

herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.).

12. At or near the end of each calendar quarter during which the New Orleans Bank for Cooperatives had a loan outstanding to the plaintiff, the bank mailed to the plaintiff a notice of the amount of interest that was due on the plaintiff's debt and the amount of the Class C stock of the bank the plaintiff was required to purchase at par value (pursuant to the loan documents which contain the requirements of the regulations and the statute) for such calendar quarter. True copies of notices typical of the one referred to are attached as Exhibits 6-A and 6-B to the Stipulation As To Facts and Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.). Exhibit 6-A is as follows:

New Orleans Bank for Cooperatives New Orleans, La.	Loan No.	Item	Amount Due
Interest			
Notice of payments due, date, June 27, 1961	From 0-2009	To 4-1-61 6-30-61	Rate 4 1/4 \$1,324.49
	F-2008		5 10,595.89
	F-2081		5 9,660.96
Prompt remittance of the amount due pay- able at par in New Orleans will be appreciated.			
C stock subscription			3,237.20
Mississippi Chemical Corporation, Box 563, Yazoo City, Mississippi:			
Principal			
Other			
Total			24,818.54

13. The board of directors of the New Orleans Bank for Cooperatives adopted a resolution on December 15, 1955, wherein it was provided that no certificate evidencing ownership of Class C stock in the bank should be issued (see Exhibit 10-C

attached to the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.)) and such bank has never issued Class C stock certificates. However, the owner of such stock was entitled to have its ownership of such stock as reflected by the books of the bank, confirmed in writing by the bank at any time upon request. Furthermore, the New Orleans Bank for Cooperatives mailed to each owner of its Class C stock as soon as practicable following the end of each fiscal year a statement setting forth the amount of such stock that was owned by such owner at the beginning and end of each such fiscal year. A true copy of a statement typical of the one referred to is attached as Exhibit 7 to the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.).

14. Exhibit 16 to the Manual for Banks for Cooperatives (which manual is attached as Exhibit 17 to the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.)) consists of the form of Class C stock certificate approved by the Farm Credit Administration for issuance by banks for cooperatives.

15. During the fiscal years ended June 30, 1961, 1962 and 1963, the plaintiff purchased 551,131.9 shares of the Class C stock of the New Orleans Bank for Cooperatives paying therefor \$100 per share (pursuant to the loan documents which contain the requirements of the regulations and the statute).

16. The following chart shows the years during which the plaintiff purchased the Class C stock of the New Orleans Bank for Cooperatives (referred to in paragraph 15); the portion of the amount paid for said stock that was deducted each year for federal income tax purposes; the portion of the amount paid for said stock that was added each year to previously reported similar investments in Class C stock; and the cumulative balance each year of the amounts reported as such investments in such Class C stock:

FYE 6/30	Par Value of Class C Stock Purchase as Above	Portion of Pur- chase Price of Class C stock Deducted Under Interest in Returns	Portion of Amount Paid For Class C Stock Reported as Investments	
			Yearly addi- tion	Cumulative Balance
1960				\$553.00
1961	\$18,940.09	\$18,751.09	\$189.00	742.00
1962	16,865.75	16,696.75	169.00	911.00
1963	19,307.35	19,114.35	193.00	1,104.00

¹ Includes \$100 paid for one qualifying share in 1956 (not in issue).

17. With respect to the chart made a part of paragraph 16:

(a) The amount listed as having been deducted in the fiscal year ended June 30, 1961, was deducted in the schedule of income and expense of the plaintiff's federal income tax return for the fiscal year ended June 30, 1961, under the heading "Other Deductions—Interest Expense: on Facility Loan, etc." The amounts listed as having been deducted in the fiscal years ended June 30, 1962 and 1963, were deducted on page 1 (Item 18) of the plaintiff's federal income tax returns for the fiscal years ended June 30, 1962 and 1963, respectively, as parts of the amounts deducted under the heading "Interest." The one qualifying share purchased in 1956 prior to obtaining any loan was treated as an investment. Thereafter, all deductions were on the basis of \$99.00 per share.

(b) Each amount listed as a yearly addition to Class C stock reported as an investment represents the difference between the amount paid for Class C stock purchased by the plaintiff during the year specified and the amount of such payment as was deducted as interest for such year.

(c) Each amount listed as a cumulative balance for a particular fiscal year is reported under the heading "Investments" or "Other Investments" in the balance sheet of the plaintiff's federal income tax return for such year.

(d) Where the shares of stock (including fractional shares) are listed in terms of par value, the number of shares involved may be determined by dividing such amounts by \$100, the par value of the stock per share.

18. The amounts paid by the plaintiff (pursuant to the loan documents which contain the requirements of the regulations and the statute) for the Class C stock of the New Orleans Bank for Cooperatives were entered on the books of said bank as

"INVESTMENT IN C STOCK (INTEREST OVERRIDE)," except the cost of the first share purchased was entered as a "QUALIFYING SHARE." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives which reflects, *inter alia*, the plaintiff's investment in Class C stock of such bank is attached hereto as Exhibit 31.

19. The New Orleans Bank for Cooperatives declared a patronage refund, based upon the interest earned on loans to the plaintiff, in the form of Class C stock to the plaintiff for each of the fiscal years ended June 30, 1960, 1961 and 1962. The par-value of the Class C stock declared for each such year as a patronage refund to the plaintiff was as follows:

FYE 6-30:	Class C Stock Par Value
1960 -----	\$28,630.64
1961 -----	27,489.40
1962 -----	25,152.83

On or about July 15 succeeding the end of each fiscal year, the bank declared patronage refunds for the preceding fiscal year based upon interest earned during such preceding fiscal year on loans to the plaintiff and on or about such date notified the plaintiff of the amount of such patronage refunds. (See Exhibit 7 attached to the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.). The plaintiff entered such patronage refunds upon its records and reported them in its federal income tax returns in the fiscal year in which it received such notice, as follows:

FYE 6-30.	Par Value of Class C Stock Declared as Patronage Refund	Amount of Patronage Refund Entered Upon Plaintiff's Records and Reported as Investment	
		Yearly Addition	Cumulative Balance
1960 -----			\$873.00
1961 -----	\$28,630.64	\$287.00	1,160.00
1962 -----	27,489.40	275.00	1,435.00
1963 -----	25,152.83	251.00	1,686.00

20. The par value of the Class C stock of the New Orleans Bank for Cooperatives which was declared as a patronage re-

fund to the plaintiff for each year was entered on the books of said bank as "PATRONAGE REFUND—C STOCK." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives whereon the plaintiff's Class C stock patronage refunds were recorded is attached hereto as Exhibit 31.

21. A part of the surplus of the New Orleans Bank for Cooperatives for each of the fiscal years ended June 30, 1961, 1962 and 1963 was allocated to the plaintiff as follows:

	Amount Allocated
1961 -----	\$12,202.89
1962 -----	11,238.75
1963 -----	12,329.84

22. The amounts of the surplus of the New Orleans Bank for Cooperatives which were allocated to the plaintiff for each year were entered on the books of said bank as "PATRONAGE REFUND—ALLOCATED SURPLUS." A true copy of the stock ledger sheet of the New Orleans Bank for Cooperatives whereon the surplus allocated to the plaintiff was recorded is attached hereto as Exhibit 31. Said bank did not notify the plaintiff in writing of the amount of surplus thus allocated to plaintiff for any year. The bank has never distributed any portion of the surplus so allocated as Class C stock.

23. The plaintiff did not enter upon its records nor include in its federal income tax returns any part of the surplus allocated to it by the New Orleans Bank for Cooperatives.

24. The federal income tax returns filed by the plaintiff for the fiscal years ended June 30, 1961, 1962 and 1963 were audited by an Internal Revenue Agent of the Internal Revenue Service. In connection with that audit, the Internal Revenue Agent prepared a report of his findings, dated January 10, 1966, and therein proposed, *inter alia*, (a) that the portion of the amount paid by the plaintiff (pursuant to the loan documents which contain the requirements of the regulations and the statute) for Class C stock of the New Orleans Bank for Cooperatives which the plaintiff had deducted in each of its federal income tax returns for the fiscal years ended June 30, 1961, 1962 and 1963 be disallowed and (b) that the par value of the Class C stock declared to the plaintiff as a patronage refund for each of the fiscal years ended June 30, 1960, 1961 and 1962, to the extent not reported as investments, be included as income in the plaintiff's federal income tax return for the next succeeding year, respectively. A true copy of the report of the Internal

Revenue Agent, dated January 10, 1966, is attached hereto as Exhibit 32.

25. The following chart shows the net income reported by the plaintiff in its federal income tax return for each of the years indicated and the additional income (net of adjustments) and the taxable income proposed in the report of the Internal Revenue Agent for each of such years, respectively.

FYE 6-30	Reported Net Income	Additional Income—Net of Adjustments	Taxable Income
1961.....	¹ \$112,832.57	\$243,080.18	\$355,912.75
1962.....	² 606,184.91	72,195.70	678,380.61
1963.....	¹ 517,575.83*	91,824.88	609,200.71
	1,236,593.31	406,900.76	1,643,494.07

¹ Income as reported after special deductions.

² Per amended return.

26. With respect to the chart made a part of paragraph 25:

(a) The amounts listed as additional income for the fiscal years ended June 30, 1961, 1962 and 1963, include the par value of the Class C stock listed in the second chart in paragraph 19 as declared to the plaintiff as patronage refunds from the New Orleans Bank for Cooperatives in the fiscal years ended June 30, 1961, 1962 and 1963, respectively. Also, for the fiscal years ended June 30, 1961, 1962 and 1963, the amounts listed as additional income include the net amounts of the par value of the Class C stock purchased from the New Orleans Bank for Cooperatives by the plaintiff (pursuant to the loan documents which contained the requirements of the regulations and the statute) which are listed in the following chart as charged (and which were charged) to interest expense by the plaintiff in such years, respectively:

FYE 6-30	Portions of Par Value of C Stock Purchased		Charged as Expense	Amounts of Patronage Refunds Reported as Invest- ments (By Decreasing Interest Expense)	Net Amounts Charged to Interest Expense
	Par Value of C Stock Purchased	Reported as In- vestments			
1961.....	\$18,940.09	\$189.00	\$18,751.09	\$287.00	\$18,464.09
1962.....	16,865.75	169.00	16,696.75	275.00	16,421.75
1963.....	19,307.35	193.00	19,114.35	251.00	18,863.35

(b) The effect of including the "Net Amounts Charged to Interest Expense" in the plaintiff's income was to deny to the plaintiff deductions of \$99.00 per share that it claimed with respect to the Class C stock it purchased and to treat such amounts as capital expenditures.

(c) Ninety-nine dollars of the par value of the Class C stock declared to the plaintiff as patronage refunds were not included as income in the plaintiff's federal income tax returns. One dollar per share was carried as a reduction of interest expense and as an asset (investment).

27. At the direction of the Commissioner of Internal Revenue, tax deficiencies were assessed against the plaintiff for each of the fiscal years ended June 30, 1961, 1962 and 1963, in the total amounts of \$126,401.69, \$36,942.49 and \$43,995.40, respectively. The assessments were based upon the taxable income proposed by the Internal Revenue Agent.

28. The tax deficiencies (referred to in paragraph 27) and the interest thereon were duly assessed against and paid by the plaintiff for its fiscal years ended June 30, 1961, 1962 and 1963.

29. On October 13, 1967, the plaintiff timely filed separate claims for refund (Form 843) with the District Director of Internal Revenue for the State of Mississippi for each of its fiscal years ended June 30, 1961, 1962 and 1963, seeking thereby to recover so much of the income tax deficiencies (plus applicable interest) assessed against and paid by it for such years as was attributable to increases in the income reported in its federal income tax returns for the fiscal years ended June 30, 1961, 1962 and 1963 to the extent that such increases resulted from (a) the disallowance of interest deductions claimed with respect to the amounts it paid (pursuant to the loan documents which contain the requirements of the regulations and the statute) for the Class C stock purchased from the New Orleans Bank for Cooperatives and (b) the inclusion in its income of the \$99.00 per share of the par value of the patronage refunds declared to it in the form of Class C stock by the New Orleans Bank for Cooperatives.

30. The claims for refund (referred to in paragraph 29) were disallowed and the plaintiff was notified of such disallowance by certified letters dated December 13, 1967. Thereafter, this action was timely instituted.

31. The following issues are to be litigated at the trial:

(a) Whether for purposes of federal income taxation the plaintiff was entitled to deduct from its gross income (as the plaintiff contends in its complaint) any part (and, if so, the amount) of the par value of the Class C stock it purchased (pursuant to the loan documents which contain the requirements of the regulations and the statute) from the New Orleans Bank for Cooperatives during the fiscal years ending June 30, 1961, 1962 and 1963. See particularly paragraph 8 hereof.

(b) Whether any part (and, if so, the amount) of the par value of the patronage refunds declared to the plaintiff in the form of Class C stock by the New Orleans Bank for Cooperatives in the fiscal years ended June 30, 1961, 1962 and 1963 was includable in the plaintiff's gross income for purposes of federal income taxation. See particularly paragraph 9 hereof.

32. Paragraphs 32 through 53, inclusive (including all exhibits and schedules referred to therein), of the Stipulation As To Facts And Documents filed on even date herewith in the case of *Coastal Chemical Corporation v. United States*, Civil Action No. 1214 (S.D. Miss.) are adopted by reference and are to be considered a part hereof.

Stipulation Exhibit 2
NEW ORLEANS BANK FOR COOPERATIVES

123

BORROWER

Coastal Chemical Corporation

ADDRESS

P.O. Box 388

Yazoo City, Mississippi

CLASS C STOCK

SURPLUS ALLOCATED TO PATRONS

RESERVE FOR CONTINGENCIES
ALLOCATED TO PATRONS

DATE	POST REF	EXPLANATION	DEBIT	CREDIT	BALANCE	MEMO YEARLY TOTAL	DEBIT	CREDIT	BALANCE	MEMO YEARLY TOTAL	DEBIT	CREDIT	BALANCE	MEMO YEARLY TOTAL
1957														
Aug 8	CA 455	QUALIFYING SHARE		100.00	100.00									
June 30	SV 7001	INVESTMENT IN C STOCK (INTEREST OVERRIDE)	1178819		115519									
June 30	SV 7012	PATRONAGE REFUND - C STOCK	1434504		2623323	2623323								
June 30	SV 7027	PATRONAGE REFUND - ALLOCATED SURPLUS					678142		678142	678142				
1959														
June 30	SV 7334	INVESTMENT IN C STOCK (INTEREST OVERRIDE)	3395620											
June 30	SV 7342	PATRONAGE REFUND - C STOCK	4736132		10755925	8131752								
June 30	SV 7339	PATRONAGE REFUND - ALLOCATED SURPLUS					2094765		2772907	2094765				
1960														
June 30	SV 7701	INVESTMENT IN C STOCK (INTEREST OVERRIDE)	4711923											
June 30	SV 7708	PATRONAGE REFUND - C STOCK	5165959		20635757	9880882								
June 30	SV 7711	PATRONAGE REFUND - ALLOCATED SURPLUS					2285555		5058462	2285555				
1961														
June 30	SV 5050	INVESTMENT IN C STOCK (INTEREST OVERRIDE)	4171258											
June 30	SV 5057	PATRONAGE REFUND - C STOCK	6054152		30861377	10225440								
June 30	SV 5054	PATRONAGE REFUND - ALLOCATED SURPLUS					2687513		7745975	2687513				
1962														
June 30	SV 5462	INVESTMENT IN C STOCK (INTEREST OVERRIDE)	3507216											
June 30	SV 5470	PATRONAGE REFUND - C STOCK	5230505		39599118	8737721								
June 30	SV 5467	PATRONAGE REFUND - ALLOCATED SURPLUS					2337057		10653062	2337057				

NEW ORLEANS BANK FOR COOPERATIVES

BORROWER

Coastal Chemical Corporation

ADDRESS

CLASS C STOCK

SURPLUS ALLOCATED TO PATRONS

RESERVE FOR CONTINGENCY
ALLOCATED TO PATRONS

DATE	POST REF.	EXPLANATION	DEBIT	CREDIT	BALANCE	MEMO YEARLY TOTAL	DEBIT	CREDIT	BALANCE	MEMO YEARLY TOTAL	DEBIT	CREDIT	BALANCE
1963					355,951.15				100,230.61				
June 30	1/1/57	INVESTMENT IN C STOCK (INTEREST OVERRIDE)		4215102									
30	1/1/57	PATRONAGE REFUND - C STOCK		6306727	50120949	10521331							
30	1/1/57	PATRONAGE REFUND - ALLOCATED SURPLUS						2691500	12774362	2691500			
1964													
June 30	1/1/57	INVESTMENT IN C STOCK (INTEREST OVERRIDE)		4458555									
30	1/1/57	PATRONAGE REFUND - C STOCK		5657952	60239786	10118537							
30	1/1/57	PATRONAGE REFUND - ALLOCATED SURPLUS						2398497	15173559	2398497			
1965													
June 30	1/1/57	INVESTMENT IN C STOCK (INTEREST OVERRIDE)		5072565									
30	1/1/57	PATRONAGE REFUND - C STOCK		6073138	71385791	11146005							
30	1/1/57	PATRONAGE REFUND - ALLOCATED SURPLUS						2545643	17719002	2545643			
1966													
April 12	1/1/57	Trans to Muscoa	449148		70936643								
June 30	1/1/57	INVESTMENT IN C STOCK (INTEREST OVERRIDE)		7601298									
30	1/1/57	PATRONAGE REFUND - C STOCK		7556526	86074467								
30	1/1/57	PATRONAGE REFUND - ALLOCATED SURPLUS						3133857	20852859				
30	1/1/57	Trans to Muscoa	416085		85678352	14292591	772560		20680299	2961297			
1967													
June 30	1/1/57	INVESTMENT IN C STOCK (INTEREST OVERRIDE)		5831143									
30	1/1/57	PATRONAGE REFUND - C STOCK		5272312	96781837	11103455							
30	1/1/57	PATRONAGE REFUND - ALLOCATED SURPLUS						2137759	22818635				

Stipulation Exhibit 5-A

NEW ORLEANS BANK FOR COOPERATIVES

LOAN AGREEMENT

Number 2371, December 7, 1961.

**COASTAL CHEMICAL CORPORATION,
Yazoo City, Mississippi,
\$2,750,000.00 Physical Facility Loan**

The findings required by law having been duly made, the New Orleans Bank for Cooperatives agrees to make loans to the above named cooperative association upon the following terms and conditions:

Amount: Not to exceed \$2,750,000.00.

Purposes: Advances made hereunder shall be used together with \$3,250,000.00 of the association's own capital funds, of which \$2,250,000.00 will be obtained from sales of class D common stock and \$1,000,000.00 from the sale of 20 year 5% convertible debentures to Mississippi Chemical Corporation, to completely finance an expansion program at Pascagoula, Mississippi, which will increase the rated capacity of the anhydrous ammonia plant from 200 tons per day to 500 tons per day. The program has been reviewed and approved by Dr. Arthur G. Keller, Chemical Engineer and Technical Advisor of the bank and will be completed in accordance with plans submitted with the loan application at total estimated cost of \$6,000,000.00.

Notes and Security: Advances made hereunder shall be evidenced by promissory note or notes acceptable to the bank and shall be secured by a deed of trust on all facilities, including interest in all land, together with all buildings, machinery, equipment, and improvements located in Jackson County, Mississippi, including the proposed additional ammonia facilities being constructed with the proceeds of this loan, subject only to prior deeds of trust in favor of the bank, securing other loans. In addition, loans shall be secured by a first mortgage on the real estate and improvements recently acquired from Arkansas Plant Food Company located in North Little Rock, Arkansas.

Loans shall also be secured by a chattel mortgage on movable fixed assets, consisting of cranes, payloaders, furniture and fixtures, and trucks owned by the association.

All stock in the bank now owned or hereafter acquired by the association and any interests of the association in and to the allocated contingency reserves and surplus of the bank now or hereafter existing shall be and hereby are pledged to the bank as security for the payment of all indebtedness of the association to the bank now or hereafter existing under this and other loan agreements. In the event that any part of said indebtedness shall be in default at any time, the bank may, at its option, retire and cancel all or part of said stock at the fair book value thereof, not exceeding par, in accordance with regulations of the Farm Credit Administration and may cancel all or part of said interest of the association in the allocated contingency reserves and surplus of the bank, in total or partial liquidation of the debt as the case may be.

Interest: Advances made hereunder shall bear interest at the rate prescribed by the bank in accordance with law, payable quarterly on the last day of each calendar quarter during the existence of the loan, provided, however, that if the interest rate charged by the bank on loans similarly classified is changed to a higher or lower rate than the rate effective on the date hereof, the association agrees to pay such higher rate and the bank agrees to accept such lower rate on the unpaid balance hereunder from the effective date of such change of interest rate.

Repayment: Advances made hereunder shall be repaid as follows:

On or before June 30, 1964	\$350,000.00
On or before June 30, 1965	350,000.00
On or before June 30, 1966	350,000.00
On or before June 30, 1967	350,000.00
On or before June 30, 1968	350,000.00
On or before June 30, 1969	350,000.00
On or before June 30, 1970	350,000.00
On or before June 30, 1971	300,000.00
Total	2,750,000.00

Expiration: Any unadvanced portion of this commitment shall be cancelled on January 1, 1963, provided that the bank may, at its option and without notice, extend said cancellation date for such period or periods of time as the bank shall, in its sole discretion, determine.

Stock Purchase: The association shall invest quarterly in class C stock of the bank at its fair book value, not exceeding par, an amount equal to 15 per cent of the amount of interest payable by the association to the bank on said loans for each calendar quarter or part thereof. The association shall pay for said class C stock on the date interest is due and payable, and the bank shall issue said class C stock to the association as of the end of each fiscal year of the bank in the amount of the payments made by the association for said class C stock during said fiscal year.

Conditions: While this loan agreement is in effect, the association will abide by the following conditions:

(a) Maintain its status as a cooperative association as defined by the Farm Credit Act of 1935.

(b) Furnish such information as the bank may request relative to its affairs and permit such examination of its books and records as the bank may specify.

(c) Maintain insurance covering such risks, in such companies, form, and amounts; and fidelity bond coverage in such Companies, form, and amounts; and on such officers and employees as the bank may request.

(d) Maintain management and business policies and an accounting system satisfactory to the bank and promptly make such changes therein as the bank may from time to time request in writing.

(e) Make no change in its charter or bylaws, pay no patronage or other dividends or rebates in cash, retire no capital or certificates of indebtedness, borrow no funds from any other source and pledge no assets without the prior written approval of the bank.

Special Conditions: Before requesting advances hereunder, the association will:

1. Furnish the bank evidence that it has sold \$2,250,000.00 of class D capital stock to producers.

2—Certify that Mississippi Chemical Corporation has invested \$1,000,000.00 in 20 year 5% convertible debentures issued by Coastal Chemical Corporation.

Default: If any representation heretofore or hereafter made by or on behalf of the association to the bank shall prove false, or if the association shall breach any of its obligations or agreements in connection herewith, the bank may decline to make further advances hereunder and may declare all indebt-

edness arising hereunder due and payable and exercise all rights and remedies for the collection thereof.

Acceptance: This agreement shall not become effective unless the association shall by December 28, 1961, signify its acceptance of the terms and conditions hereof by signing and returning a copy of this agreement to the bank.

By Direction of the Executive Committee, this the 7th day of December 1961.

NEW ORLEANS BANK FOR COOPERATIVES,

By N. J. PENDLETON,

President.

Agreed to and accepted:

COASTAL CHEMICAL CORPORATION,

By O. COOPER, *President.*

Dated: DECEMBER 8, 1961.

MC-117-Sub. 332

LOAN NO.	ITEM	AMOUNT DUE
	INTEREST:	
	TERM	
	DATE	
C-200.9	h-2-61 6-30-61	1,321.40
F-2008		10,855.89
F-2081		9,660.98
	C STOCK SUBSCRIPTION:	3,237.20
	PRINCIPALS	
	OTHER:	
	TOTAL	24,015.47

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LOAN NO.	ITEM	AMOUNT DUE
	INTEREST:	
	TERM	RATE
F-2128	4-1-61 6-30-61	5
F-2239		5
		15,093.15
		5,319.32
	C STOCK SUBSCRIPTION:	7,500.00
	PRINCIPAL:	
	OTHER:	
	TOTAL	50,000.00

Stipulation Exhibit 7

NEW ORLEANS BANK FOR COOPERATIVES

FIFTH FARM CREDIT DISTRICT, ALABAMA-MISSISSIPPI-LOUISIANA

P.O. Box 50072

New Orleans, Louisiana 70150, July 15, 1963.

MISSISSIPPI CHEMICAL CORPORATION,

P.O. Box 563,

Yazoo City, Mississippi

Subject: Notification of patronage refund for fiscal year
June 30, 1963, payable in Class C stock.

GENTLEMEN: For the year ended June 30, 1963, the bank's earnings, after provision for franchise tax, dividends on Class B stock, and transfers to allocated surplus, amounted to \$312,759.20. In accordance with our bylaws, these earnings are to be distributed in Class C stock to borrowing associations in proportion to the total gross interest earnings. Since our gross interest for this period amounted to \$1,393,550.74, this patronage refund amounts to 22.44333 per cent of the gross interest.

We accordingly wish to officially notify you that your Class C stock patronage refund for the year ended June 30, 1963, amounts to \$28,888.10, and has been set up on the records of the bank. It is our recommendation that this amount be reflected in your records by a debit to investments in C stock in the bank and a credit to your operating income at face value.

For your general information, we present below a statement of your cooperative's investment in the capital accounts of this bank as of the close of business June 30, 1963, after giving effect to the above Class C stock patronage refund:

	Balance at June 30, 1962	Changes During Year	Balance at June 30, 1963
Class B stock	\$150,000.00		\$150,000.00
Class C stock:			
Qualifying share	100.00		100.00
From quarterly investment by cooperative associa- tions (15% of interest)	81,072.38	\$19,307.35	100,379.73
From earnings distributed as a patronage refund in C stock	168,643.11	28,888.10	197,531.21
Total C stock	249,815.49	48,195.45	298,010.94

Yours very truly,

D. M. NETTLES,
Vice President and Treasurer

Stipulation Exhibit 8

EXCERPT FROM THE MINUTES OF THE MEETING
OF THE BOARD OF DIRECTORS OF THE NEW
ORLEANS BANK FOR COOPERATIVES HELD MAY
20, 1959

In discussing interest rates Mr. Chavanne mentioned the desirability of having some goal for the rate of class A stock retirement. Each director was handed copy of a schedule (Exhibit 2) showing a proposed program for retirement of class A stock over a period of 20 years. After discussion, motion was made, seconded, and unanimously carried approving this schedule for class A stock retirement as a general objective with the understanding that, under very high interest rate conditions or in the event of some substantial loss on bad loans, the bank would find it necessary to deviate from the scheduled rate of retirement.

I hereby certify that the above is a true and exact excerpt from the minutes of the regular meeting of the Board of Directors of the New Orleans Bank for Cooperatives held on May 20, 1959.

Dated this 3rd day of December, 1965.

C. D. POWELL,
Assistant Secretary

N.O.B.C. Program of Class A Stock Retirement

Year Ended	Actual	Goal	
		Retire	Balance
Original A stock			\$7,000,000
6-30-56	\$71,900	\$71,900	6,928,100
6-30-57	181,300	181,300	6,746,800
6-30-58	229,800	229,800	6,517,000
6-30-59		247,000	6,270,000
6-30-60		270,000	6,000,000
6-30-61		275,000	5,725,000
6-30-62		275,000	5,450,000
6-30-63		300,000	5,150,000
6-30-64		300,000	4,850,000
6-30-65		325,000	4,525,000
6-30-66		350,000	4,175,000
6-30-67		375,000	3,800,000
6-30-68		400,000	3,400,000
6-30-69		400,000	3,000,000
6-30-70		400,000	2,600,000
6-30-71		400,000	2,200,000
6-30-72		400,000	1,800,000
6-30-73		400,000	1,400,000
6-30-74		400,000	1,000,000
6-30-75		400,000	600,000
6-30-76 (20 years)		600,000	

Stipulation Exhibit 9-E

*New Orleans Bank for Cooperatives, Class C Stock and Allocated Surplus
Applied in Liquidations, January 1, 1956-June 30, 1963*

Date	Association Liquidated	Address	Write-Off	
			C Stock	Allocated Surplus
5-19-60	Blue Lake Gin Company of Itta Bena.	Itta Bena, Miss.	\$2, 596. 49	\$645. 23
6-30-60	Blue Lake Gin Company of Itta Bena.	Itta Bena, Miss.	665. 23	294. 15
Total			3, 261. 72	939. 38
5-19-60	Delta Rice Growers Association, Inc.	Greenville, Miss.	5, 563. 03	2, 188. 43
6-30-60	Delta Rice Growers Association, Inc.	Greenville, Miss.	1, 056. 86	467. 31
Total			6, 619. 89	2, 655. 74
4-14-61	Linwood Elevator	Vaughn, Miss.	802. 30	
4-14-61	Linwood Elevator	Vaughn, Miss.	1, 789. 37	647. 57
6-30-61	Linwood Elevator	Vaughn, Miss.	181. 15	80. 42
7-1-61	Linwood Elevator	Vaughn, Miss.	146. 24	64. 91
Total			2, 919. 06	792. 90
4-8-60	Southern Guernsey Dairies (AAL)	Hernando, Miss.	1, 944. 46	498. 30
6-30-60	Southern Guernsey Dairies (AAL)	Hernando, Miss.	240. 98	106. 55
Total			2, 185. 44	604. 85

NOTE: In each of the above transactions the cooperative went out of business and was liquidated and there was a write-off of the allocated surplus and the "C" stock, thereby reducing the total book value of the "C" stock and allocated surplus upon the balance sheet of the Bank.

In each instance, the properties subject to the security documents were foreclosed and bought by the Bank.

Stipulation Exhibit 10-C

RESOLUTION OF THE BOARD OF DIRECTORS OF THE NEW ORLEANS
BANK FOR COOPERATIVES

Be it resolved that no certificates evidencing ownership of Class C stock in the New Orleans Bank for Cooperatives, or evidencing ownership of stock issued as of a date prior to January 1, 1956, shall be issued by the Bank. If any owner of such stock shall so request, the Bank shall furnish at any time a written statement as to the amount of such stock owned by any borrower, as reflected by the books of the Bank.

I hereby certify that the above and foregoing is a true and correct copy of a resolution adopted by the Board of Directors of the New Orleans Bank for Cooperatives at its meeting on December 15, 1955.

E. F. CHAVANNE,
Secretary

Approved: December 27, 1955.

HOMER G. SMITH,
Director of Cooperative Bank Service

Stipulation Exhibit 10-D

RESOLUTION OF THE BOARD OF DIRECTORS OF THE NEW ORLEANS
BANK FOR COOPERATIVES

In accordance with Article IV, Section 9(b) of the by-laws of the New Orleans Bank for Cooperatives, as amended this date, ownership of Class B stock in said bank shall be evidenced by a certificate in the following form:

Original Date of Issue
Certificate No.

NEW ORLEANS BANK FOR COOPERATIVES
NEW ORLEANS, LOUISIANA

(Incorporated under the Act of Congress known as the Farm
Credit Act of 1933.)

CLASS B STOCK, SERIES

This is to certify that is the owner of
..... shares of Class B stock, Series, of the NEW
ORLEANS BANK FOR COOPERATIVES, each share hav-
ing a par value of \$100.

The stock evidenced hereby is issued with the approval of the Farm Credit Administration pursuant to and in accordance with the provisions of section 42(a) (2) of the Farm Credit Act of 1933, as amended by section 101 of the Farm Credit Act of 1955, and is non-voting.

Dividends at a rate of not to exceed four per centum per annum may be paid on the stock evidenced hereby if declared by the Board of Directors of the Bank and approved by the Farm Credit Administration, and if the surplus account of the Bank, after the payment of such dividends, will be not less than 25 per centum of the sum of all outstanding capital stock of the Bank. Dividends shall not be cumulative, but no net savings of the Bank for any fiscal year shall be distributed as patronage refunds unless for that year a dividend at the rate of at least two per centum per annum is declared and paid upon the stock evidenced hereby. Dividends shall be computed in accordance with the bylaws of the Bank in the same manner as interest is computed.

The stock evidenced hereby may be transferred to any person with the approval of the Bank, but no such transfer shall be binding upon the Bank until this certificate is surrendered to the Bank with a duly executed assignment endorsed hereon or accompanying the same. The Bank has a first lien on the shares of stock evidenced by this certificate for all indebtedness of the owner of record to the Bank.

After all class A stock of the Bank has been retired, class B stock may be called for retirement at par, in full or on a pro rata basis, with the approval of the Farm Credit Administration, provided that the oldest outstanding class B stock at any given time shall be retired first, and provided that any holder of class B stock whose stock has been called for retirement may elect, with the approval of the Bank, to leave his stock in the Bank subject to its being included in the next call for retirement.

The order of retirement of the shares of stock evidenced by this certificate shall be determined by the original date of issue specified above.

In case of liquidation or dissolution of the Bank all capital stock of the Bank issued before the effective date of Title I of the Farm Credit Act of 1955, all class A stock, and all class B stock shall be retired at par after the payment of all liabilities of the Bank and prior to the retirement of any class C stock or distribution of surplus or contingency reserves.

Subject to rules prescribed by the Board of Directors of the Bank with the approval of the Farm Credit Administration, the stock evidenced hereby may be converted into class C stock for the purpose of making the investment, if any, required of the holder of record of this certificate by section 42(a) (3) of the Farm Credit Act of 1933, as amended.

The stock evidenced hereby is subject to the provisions of the Farm Credit Act of 1933, and acts amendatory thereof and supplementary thereto, and as they may hereafter be amended.

IN WITNESS WHEREOF, the New Orleans Bank for Cooperatives has caused this certificate to be issued and its corporate seal to be hereto affixed by its duly authorized officers this day of, 19.....

.....
President

Attest:

.....
Secretary

I hereby certify that the foregoing is a true and correct copy of a resolution adopted by the Board of Directors of the New Orleans Bank for Cooperatives at its meeting held on the 15th day of December, 1955.

E. F. CHAVANNE,
Secretary

Approved: December 27, 1955.

HOMER G. SMITH,
Director of Cooperative Bank Service

Stipulation Exhibit 11

EXCERPT FROM THE MINUTES OF THE MEETING OF THE BOARD,
OF DIRECTORS OF THE NEW ORLEANS BANK FOR COOPERATIVES
HELD NOVEMBER 15, 1961

The board fully discussed regulations issued by the Farm Credit Administration pertaining to the cancellation and retirement of stock and other equities of a borrower in liquidation or dissolution. The consensus was that for the time being the board would prefer to review each individual case before approving the retirement of stock and other equities of any such borrower.

I hereby certify that the above is a true and exact excerpt from the minutes of the regular meeting of the Board of

Directors of the New Orleans Bank for Cooperatives held on November 15, 1961.

Dated this 21st day of December, 1965.

C. A. PONSILL,
Assistant Secretary

Stipulation Exhibit 12-A, page 3

BOARD OF DIRECTORS

C. O. STOKES, Chairman
Ozark, Alabama

Elected by the production credit associations

E. P. GARRETT, Vice Chairman
Decatur, Alabama

*Appointed by the Governor of the
Farm Credit Administration*

A. B. ADAMS
Clarksdale, Mississippi
*Elected by the federal land
bank associations*

W. W. FUSSELL
Metairie, Louisiana
*Elected by the federal
land bank associations*

F. A. GRAUGNARD, Jr.
St. James, Louisiana
*Appointed by the Governor
of the Farm Credit
Administration*

A. L. SEVIER
Tallulah, Louisiana
*Elected by the production
credit associations*

E. G. SPIVEY
Jackson, Mississippi
*Elected by stockholders of the
New Orleans Bank for Cooperatives*

J. L. RYAN, General Agent
Farm Credit Banks of New Orleans

STAFF

N. F. PENDLETON
President

D. M. NETTLES
Treasurer*

J. C. BURAS
Assistant Treasurer

L. J. MAUFFRAY
Chief Accountant

F. D. LOGAN
Business Analyst

W. C. VERLANDER, Jr.
Secretary

D. R. STUMP
Assistant to the President
and Attorney

C. D. POWELL
Assistant Secretary

R. E. KILLEEN
Business Analyst

T. T. HOLMAN
Business Analyst

V. R. MORICI
Business Analyst

*Effective August 1, 1961.

Stipulation Exhibit 12-A, pp. 10-11

NEW ORLEANS BANK FOR COOPERATIVES

STATEMENT OF CONDITION

JUNE 30, 1961

ASSETS

Loans:		
Commodity	\$ 700,000.00	
Operating capital	7,215,483.52	
Facility	11,918,763.11	\$20,334,246.63
Total		
Less: Participation of other banks for cooperatives	2,221,722.43	
Reserve	189,591.86	
Net loans		2,410,714.39
Cash—general funds		17,923,532.24
U. S. Government securities—at amortized cost (par \$2,335,000.00)		433,812.52
Investment in Central Bank capital stock		2,399,809.30
Accounts receivable		376,810.09
Accrued interest receivable		52,293.40
Notes receivable		312,057.18
Assets acquired in liquidation of loans		185,970.77
Less: Reserve	36,800.70	
Automobiles, furniture, fixtures and equipment	27,000.00	9,800.70
Less: Reserve	25,010.77	
Prepaid and deferred expenses	25,010.77	None
Other assets		12,770.54
TOTAL ASSETS		5,040.75
		<u>\$21,923,697.49</u>

Notes:

A. Loans of \$9,621,013.12 are pledged as security for borrowings.

B. The unamortized consolidated debentures represent the bank's participation in consolidated debentures outstanding in the total amount of \$282,000,000 for which the 12 banks for cooperatives are jointly and severally liable.

Loan commitments outstanding

\$13, 839, 026.89

LIABILITIES

Unamortized consolidated debentures	\$ 8,000,000.00
Notes payable—Central Bank for Cooperatives	1,500,000.00
Accrued interest payable	61,076.78
Federal franchise tax payable	74,506.49
Dividends payable—Class B stock	12,112.42
Due U. S. Government—Refinancing of Class A stock	350,000.00
Other liabilities	81,849.49
TOTAL LIABILITIES	<u>10,079,545.16</u>

STOCKHOLDERS EQUITY

Capital stock:	
Class A—U. S. Government	\$4,620,000.00
Class B—cooperative associations	403,747.34
Class C—cooperative associations	1,779,262.16
Surplus—reserves	
Surplus—allocated to persons	7,753,008.50
	3,627,898.15
	463,454.86
TOTAL STOCKHOLDERS' EQUITY	<u>11,844,352.32</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$21,923,697.49</u>

Total loans since organization

\$543,503,985.22

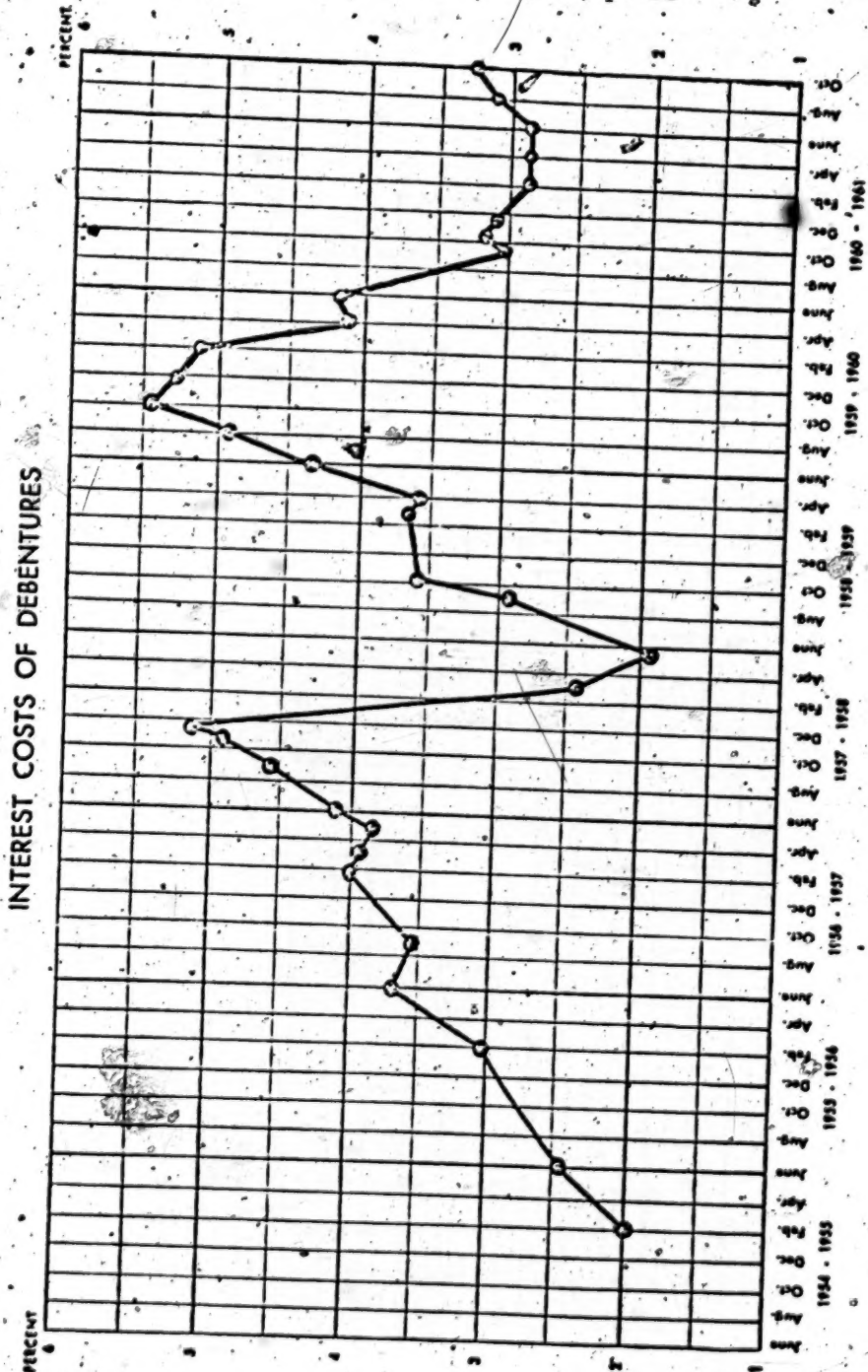
INTEREST RATES

Interest costs of debentures reached a peak of almost $5\frac{1}{2}$ per cent in October of 1959 after a sharp rise from less than 2 per cent in June of 1958. From October, 1959 to June of 1961, the rate has declined sharply, with the issue of June 1, 1961 selling at 2.80 per cent. By virtue of this, the bank was able to reduce interest rates from $5\frac{1}{2}$ per cent on term loans to 5 per cent during the past fiscal year and also reduce operating or seasonal loans from $5\frac{1}{4}$ per cent to $4\frac{1}{4}$ per cent. The rates which are currently in effect are, as follows:

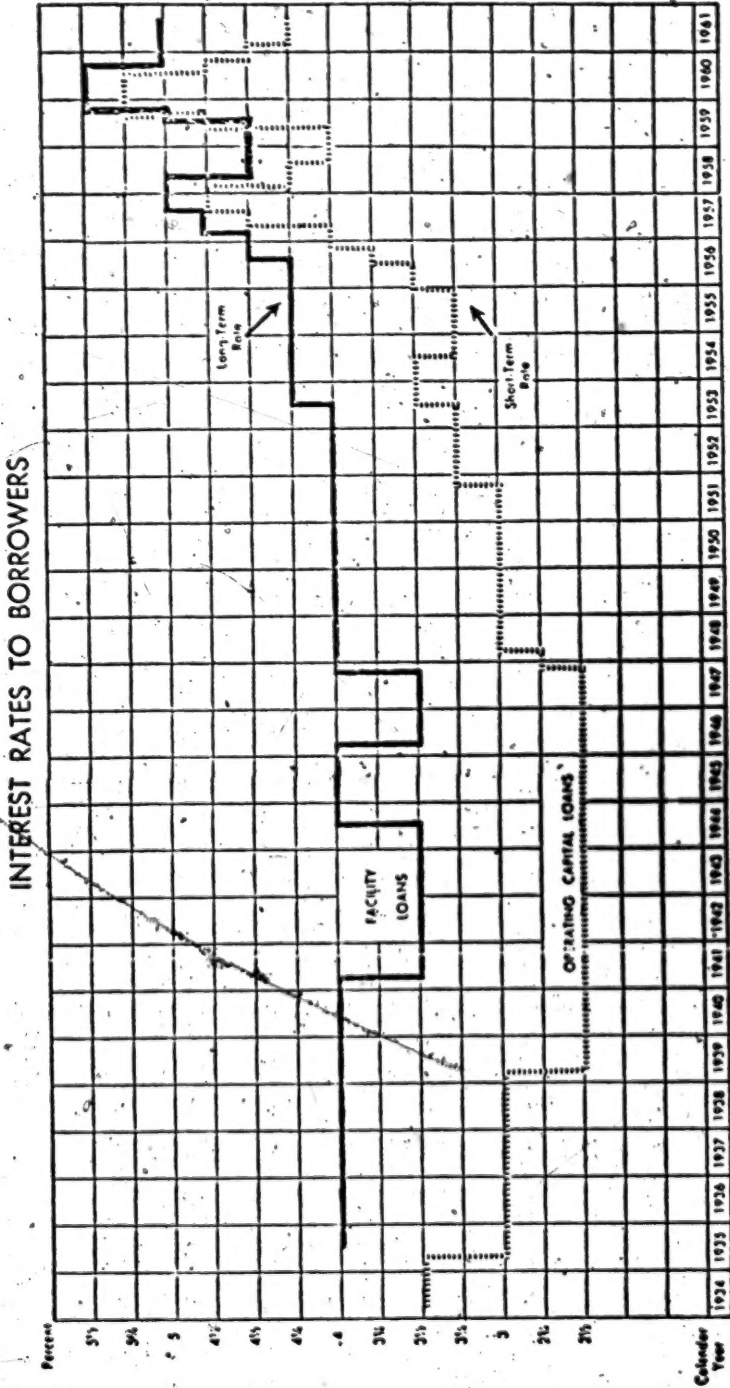
Commodity loans	4 per cent
Seasonal operating loans	$4\frac{1}{4}$ per cent
Facility and term operating loans	5 per cent

As this is written (October, 1961) the cooperative banks have sold two issues of debentures, one each in August and October at rates of 3.05 per cent and 3.25 per cent respectively. Although there is still outstanding one debenture issue which cost 2.80 per cent, it will mature in December, 1961. From all indications, the cost to replace this money will probably be higher than our recent issue at 3.25 per cent. Since the trend appears to be paralleling on a smaller scale, the experience of two years ago, it may be necessary to raise bank rates accordingly. The following graphs reflect the interest rates charged the bank's borrowers and the interest costs of the bank's debentures:

Stipulation Exhibit 12-A, p. 14



Stipulation Exhibit 12-A, p. 15



Stipulation Exhibit 12-B, page 3

BOARD OF DIRECTORS

C. O. STOKES, Chairman
Ozark, Alabama

Elected by the production credit associations

E. P. GARRETT, Vice Chairman
Decatur, Alabama

*Appointed by the Governor of the
Farm Credit Administration*

A. B. ADAMS
Clarksdale, Mississippi
*Elected by the federal
land bank associations*

W. W. FUSSELL
Metairie, Louisiana
*Elected by the federal
land bank associations*

F. A. GRAUGNARD, Jr.
St. James, Louisiana
*Appointed by the
Governor of the Farm
Credit Administration*

L. W. WADE*
Greenwood, Mississippi
*Elected by the production
credit associations*

E. G. SPIVEY
Jackson, Mississippi
*Elected by stockholders of the
New Orleans Bank for Cooperatives*

J. L. RYAN, General Agent
Farm Credit Banks of New Orleans

E. F. STEINER, General Counsel
Farm Credit Banks of New Orleans

*Elected by POAs June 30, 1962, to complete the unexpired term of A. L. Sevier, whose term of office expires December 31, 1963.

STAFF

N. F. PENDLETON
President

D. M. NETTLES
Treasurer

J. C. BURAS
Assistant Treasurer

L. J. MAUFFRAY
Chief Accountant

E. D. LOGAN
Business Analyst

W. C. VERLANDER, Jr.
Secretary

D. R. STUMP
Assistant to the President
and Attorney

C. D. POWELL
Assistant Secretary

R. E. KILLEEN
Business Analyst

T. T. HOLMAN
Business Analyst

V. R. MORICI
Business Analyst

Stipulation Exhibit 12-B, page 18

SPECIAL SERVICES TO COOPERATIVE GROUPS

From the commencement of its operation it has been the policy of the bank to aid in the development of sound cooperatives in its district. This program provides not only financial assistance but also constructive service to cooperatives and advice to farmers contemplating the establishment of cooperatives. As a loan service the bank continues to make regular field visits to borrowing cooperatives to the extent possible with available personnel. The use of group cooperative conferences is believed to be valuable in carrying out the objectives and purposes of the cooperative program in this district. During the fiscal year a stockholders' meeting was held in Biloxi, Mississippi.

The annual meeting of sugar cooperatives was held in New Orleans, and the annual meeting of the cooperative rice driers was held in Jennings, Louisiana.

The bank, the other Farm Credit Institutions of the New Orleans area, the three state agricultural colleges, and the three state cooperative councils, comprise the Tri-State Committee on Farmer Cooperative Research and Education. This is an informal organization which meets twice yearly and seeks to coordinate and improve the work in cooperative research and education in the Fifth Farm Credit District.

Conferences were held by members of the bank's staff with groups of farmers contemplating the establishment of new cooperatives. More than half of the associations regularly financed by the bank are the outgrowth of such conferences.

DIRECTORATE

The New Orleans Bank for Cooperatives is governed by a board of directors of seven men who are residents of the district and who also serve as directors of the other two farm credit banks of New Orleans. Two of the members of the board are elected by the federal land bank associations in the district, two by the production credit associations, one by stockholders of this bank, and two are currently appointed by the Governor of the Farm Credit Administration. The law provides that the stockholders of the bank for cooperatives shall elect one additional director (now appointed by the Governor) after the capital ownership of the cooperatives reaches a prescribed minimum.

The amended Farm Credit Act of 1953, which put the Farm Credit system on an independent agency status, also established a Farm Credit Board of 13 members who have general policy supervision of the national system. The fifth Farm Credit District representative of that board is J. Pittman Stone of Coffeeville, Mississippi, whose term of office extends to March 31, 1965.

N. F. PENDLETON,
President.

Stipulation Exhibit 12-C, page 3

BOARD OF DIRECTORS

W. W. FUSSELL, Chairman
Metairie, Louisiana

Elected by the federal land bank associations

F. A. GRAUGNARD, Jr., Vice Chairman
St. James, Louisiana

*Appointed by the Governor of the
Farm Credit Administration*

A. B. ADAMS

Clarksdale, Mississippi

*Elected by the federal
land bank associations*

C. O. STOKES

Ozark, Alabama

*Elected by the production
credit associations*

E. P. GARRETT

Decatur, Alabama

*Appointed by the Governor
of the Farm Credit
Administration*

L. W. WADE

Greenwood, Mississippi

*Elected by the production
credit associations*

E. G. SPIVEY

Jackson, Mississippi

*Elected by stockholders of the New Orleans Bank for
Cooperatives*

J. L. RYAN, Chairman, Presidents' Committee
Farm Credit Banks of New Orleans

E. F. STEINER, General Counsel
Farm Credit Banks of New Orleans

STAFF

N. F. PENDLETON
President

D. M. NETTLES
Vice President and
Treasurer

J. C. BURAS
Assistant Treasurer

L. J. MAUFFRAY
Chief Accountant

E. D. LOGAN
Business Analyst

W. C. VERLANDER, Jr.
Vice President and
Secretary

D. R. STUMP
Assistant to the President
and Attorney

C. D. POWELL
Assistant Secretary

R. A. MURPHY, Jr.
Business Analyst

T. T. HOLMAN
Business Analyst

V. R. MORICI
Business Analyst

STATEMENT OF CONDITION

JUNE 20, 1943

ASSETS		LIABILITIES	
Loans:		Unmatured consolidated debentures	\$10,500,000
Commodity	\$ 1,000,000	Notes payable—Central Bank for Cooperatives	1,450,000
Operating capital	9,701,538	Accrued interest payable	94,546
Facility	17,238,421	Federal franchise tax payable	75,724
	27,939,959	Dividends payable—Class B stock	11,997
Less: Participation of other Banks for cooperatives	7,170,320	Due U. S. Government—retirement at class A stock	390,000
Net loans	20,769,639	Trust accounts	60,725
Notes receivable	177,543	Other liabilities	44,043
Accrued interest receivable (net)	364,663	TOTAL LIABILITIES	12,627,125
	21,311,845		
	<u>312,270</u>		
Less: Reserves			
Net loans, notes and accrued interest receivable	\$20,999,575		
Cash—general funds	616,994	STOCKHOLDERS' EQUITY	
U. S. Government securities at amortized cost (par \$2,595,000)	2,573,944	Capital stock	
Investment in Central Bank stock	600,862	Class A—U. S. Government	\$4,880,000
Equity in allocated surplus of Central Bank	40,940	Class B—Cooperative associations	399,562
Accounts receivable		Class C—Cooperative associations	2,681,548
Assets acquired in liquidation of loans		Surplus—reserved	
Automobiles, furniture, fixtures and equipment	29,610	Surplus—allocated to patronus	711,446
Less: Reserves	29,610	TOTAL STOCKHOLDERS' EQUITY	12,300,445
Prepaid and deferred expenses		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$24,927,571
Other assets	7,569		
Other assets	\$24,927,571		

Water

A Loans of \$12,352,380 are pledged as security for borrowings.

At the same time, the book's presentation of the various political and social movements of the 1960s and 1970s is a testament to the author's commitment to social justice and his belief in the power of the individual to effect change.

8. The unaudited consolidated balance sheet reflects the total amount of \$462,000,000 in consolidated debentures outstanding in the total amount of \$462,000,000.

for which the 13 banks for co-operatives are jointly and severally liable.

100-200-700

Loan commitments outstanding .

1

4

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1

Stipulation Exhibit 12-C, page 13

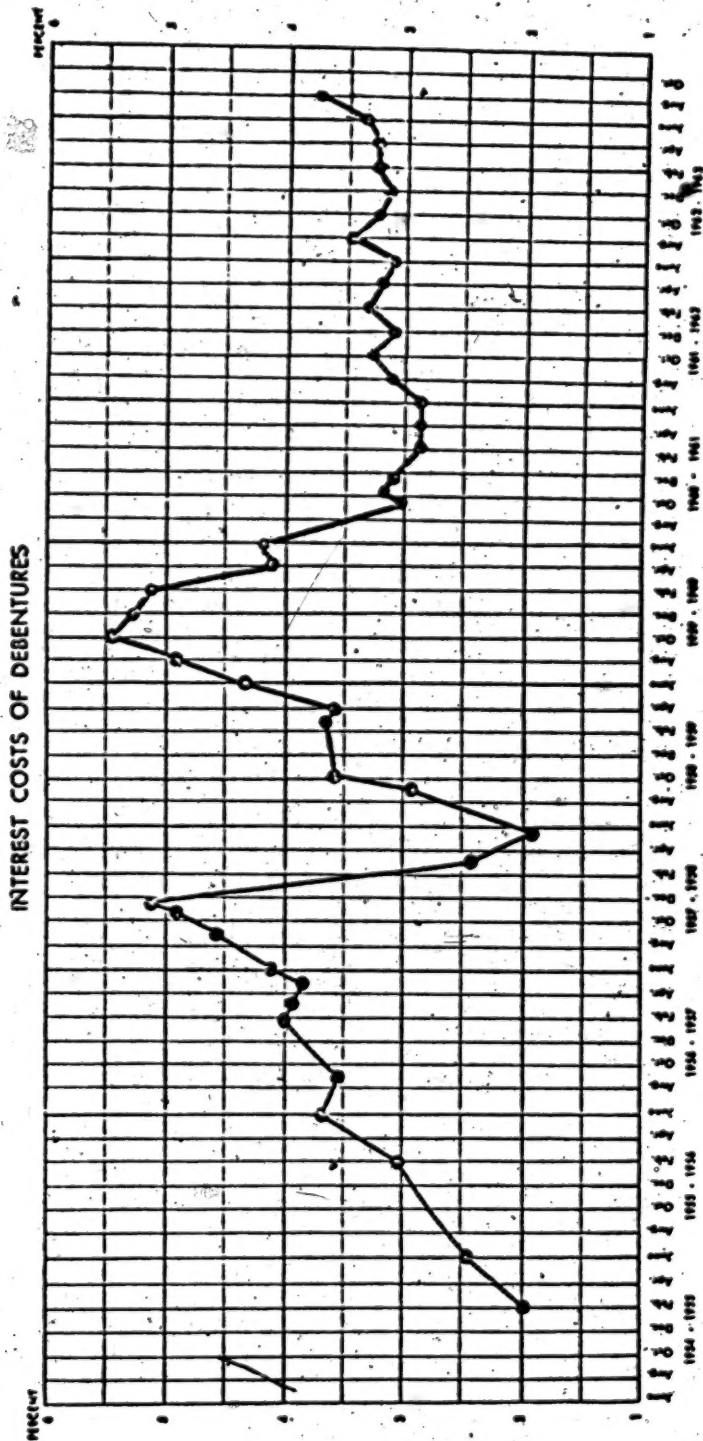
INTEREST RATES

During the past fiscal year (1962-63), debenture costs ranged from a high of 3.475 (including commissions) in August, 1962, to a low of 3.15 in December, 1962. The rate leveled at 3.25 for the February and April sales with the last issue during the fiscal year (June 3, 1963) selling at 3.30. The pattern shows a gradual rise over the past 3 fiscal years. However, as a result of the increase in Federal Reserve discount rate to member banks from 3 per cent to 3½ per cent in July and other factors, the debenture issue of August 1, 1963, showed a sharp increase in rate, selling at 3.725. The October 1 issue further affirmed the higher cost by selling at 3.90 per cent. Because of these increases, the bank's board of directors was compelled to raise interest rates ¼ per cent on all loans effective September 1, 1963. This was the first change since February, 1961.

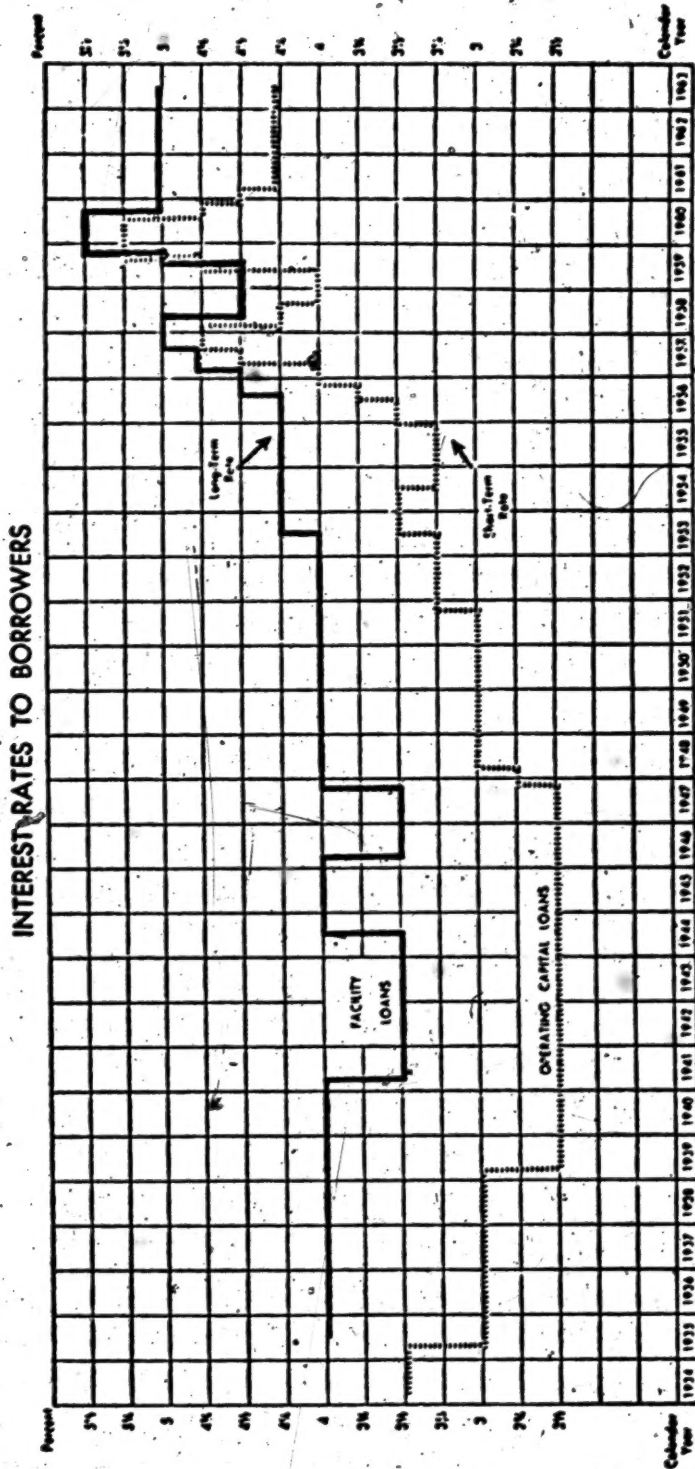
At this writing, from all indications, the cost of money will remain at a higher level for a period of time.

The following graphs reflect the interest rates charged the bank's borrowers and the interest costs of debentures:

Stipulation Exhibit 12-C, page 14



Stipulation Exhibit 12-C, page 15



Stipulation Exhibit 12-C, page 19

DIRECTORATE

The New Orleans Bank for Cooperatives is governed by a board of directors of seven men who are residents of the district and who also serve as directors of the other two farm credit banks of New Orleans. Two of the members of the board are elected by the federal land bank associations in the district, two by the production credit associations, one by stockholders of this bank, and two are currently appointed by the Governor of the Farm Credit Administration. The law provides that the stockholders of the bank for cooperatives shall elect one additional director (now appointed by the Governor) after the capital ownership of the cooperatives reaches a prescribed minimum.

The amended Farm Credit Act of 1953, which put the Farm Credit system on an independent agency status, also established a Farm Credit Board of 13 members who have general policy supervision of the national system. The Fifth Farm Credit District representative of that board is J. Pittman Stone of Coffeeville, Mississippi, whose term of office extends to March 31, 1965.

N. F. PENDLETON,

President

Stipulation Exhibit 15

BYLAWS

ARTICLE I.—DIRECTORS

Section 1.—The duly qualified members of the Farm Credit Board of New Orleans shall constitute ex officio the Board of Directors of the New Orleans Bank for Cooperatives.

Section 2.—The business and affairs of the Bank shall be conducted under the supervision and control of its Board of Directors, subject to the applicable provisions of the laws of the United States and to the supervision of the Farm Credit Administration as prescribed therein.

Section 3.—There shall be an annual meeting of the Board of Directors on the Wednesday next following the third Monday of January of each and every year at the hour of 10 o'clock A.M., or as soon thereafter as practicable on that day or the

next day; or, if the day prescribed herein be a holiday, at the same hour on the first full business day thereafter, provided that such annual meeting may be held on a different date and time during the month of January of any such year if such date and time shall have been fixed by resolution adopted by the Board of Directors at a regular or special meeting held during the preceding month or earlier, or with the unanimous consent of the Board of Directors.

There shall be a regular meeting of the Board of Directors on the Wednesday next following the third Monday of each and every month at 10 o'clock A.M., or as soon thereafter as practicable on that day or the next day (unless a different date and time for such meeting during any month shall have been fixed by resolution adopted by the Board of Directors at a regular or special meeting held during the preceding month or earlier, or with the unanimous consent of the Board of Directors); or if that day be a holiday, at the same hour on the first full business day thereafter; provided that the regular meeting of the Board of Directors for the month of January shall be held immediately following the annual meeting of the Board of Directors. The Chairman of the Board may call a special meeting at any time, and he shall do so upon written request of any three directors. All meetings of the Board of Directors shall be held at the offices of the Bank unless some other place is fixed by the Board of Directors or is stated in the notice of the meeting. Notice of regular or special meetings of the Board may be given by mail or telegraph. If given by mail, such notice shall be mailed at least five (5) days before the date of meeting. If given by telegraph, such notice shall be dispatched at least two days before the date of the meeting. Notice of any meeting may be dispensed with if each of the directors shall, in writing, waive such notice.

Notice of regular and special meetings of the Board may be given by the General Agent of the Farm Credit District of New Orleans, with like effect as though given by the Secretary of the Bank; and a copy of such notice, together with the written statement of the General Agent that such notice has been given, specifying the manner in which it was given, shall be sufficient evidence to authorize the Secretary to incorporate into the record an appropriate recital with respect to the giving of notice.

The directors shall elect a Chairman who shall preside at all meetings of the Board of Directors. The Chairman need not be a director.

Section 4.—A majority of the Board of Directors shall constitute a quorum for the transaction of business, but less than a quorum may adjourn from time to time until a quorum is in attendance.

ARTICLE IV.—CAPITAL STOCK

Section 1.—Capital stock of the Bank shall consist of class A stock, class B stock, and class C stock, as provided in section 42(a) of the Farm Credit Act of 1933, as amended, all of which shall have a par value of \$100 per share, in addition to stock issued before the effective date of Title I of the Farm Credit Act of 1955 and stock having the same rights and subject to the same limitations which is issued on and after said effective date in accordance with firm loan commitments of the Bank made prior to said effective date. Subsequent reference in these bylaws to stock issued before the effective date of Title I of the Farm Credit Act of 1955 shall be deemed to include stock having the same rights and subject to the same limitations which is issued on and after said effective date in accordance with firm loan commitments of the Bank made prior to said effective date. All stock of the Bank shall be issued, sold, transferred, held, owned and retired in accordance with the applicable provisions of the Farm Credit Act of 1933, as amended, and by the terms and provisions of these bylaws.

Section 2.—(a) Class B stock may be issued from time to time in series and amounts authorized by the Board of Directors and approved by the Farm Credit Administration. The resolution of the Board of Directors authorizing the issuance of class B stock shall specify, subject to the approval of the Farm Credit Administration, (1) the total amount authorized to be issued, (2) the maximum rate of dividend which may be paid thereon (not exceeding 4 per centum per annum), (3) the minimum rate of dividend which shall be paid thereon before the Bank may distribute any of its net savings as patronage refunds (at least 2 per centum per annum), and (4) any other terms and conditions not inconsistent with law, including a waiver of the Bank's statutory lien, that the Board of Directors in its discretion may prescribe.

(b) Class C stock, except as authorized by the Board of Directors and approved by the Farm Credit Administration, may be issued only to farmers' cooperative associations as defined in section 15(a) of the Agricultural Marketing Act, as amended.

Section 3.—(a) No dividends shall be paid on class A stock or class C stock or on stock issued before the effective date of Title I of the Farm Credit Act of 1955.

(b) Dividends on class B stock which are declared for any fiscal year shall be payable to stockholders of record on the last day of such fiscal year on the class B stock outstanding on the last day of such fiscal year except that in the case of class B stock which has been retired during the fiscal year, dividends shall be payable to the holders of record on the date of such retirement. The dividend payable on each share of stock shall be computed at the dividend rate declared by the Board of Directors for the number of days that such share of stock was outstanding (determined for the first year from the original date of issue shown on the stock certificate) during the fiscal year in the same manner as interest is computed. Such computation shall be on the basis of a fiscal year of 365 days. Dividends payable to any borrower from the Bank whose indebtedness to the Bank is in default may, in the discretion of the Bank, be applied to reduce such indebtedness.

Section 4.—Ownership of capital stock shall be recorded on the books of the Bank and shall be evidenced as provided in section 8 of this article. Class B stock may be sold or transferred to any person subject to the approval of the Bank. Class C stock, except as authorized by the Board of Directors and approved by the Farm Credit Administration, may be transferred only to farmers' cooperative associations as defined in section 15(a) of the Agricultural Marketing Act, as amended. No transfer of stock shall be binding upon the Bank until the certificate therefor, if any, is surrendered to the Bank and until a duly executed assignment in form acceptable to the Bank is delivered to the Bank. Any transfer of stock or of any interest therein shall be subject to the lien of the Bank for all indebtedness to the Bank of the owner of record at the time of transfer. The Executive Committee of the Bank may waive the lien of the Bank on any stock held by a borrower to permit its transfer free of the lien if in the judgment of the committee

such waiver will not jeopardize the collectibility of the borrower's indebtedness to the Bank.

Section 5.—(a) Class A and class C stock may not be converted to any other class of stock.

(b) Unless otherwise provided by a resolution of the Board of Directors, class B stock may be converted into class C stock by borrowers for the purpose of making the investment in class C stock required under the provisions of section 42(a)(3) of the Farm Credit Act of 1933, as amended. No class B stock shall be converted to class C stock unless the borrower has in writing requested such conversion and has delivered to the Bank the certificate evidencing the stock to be so converted, except that the Board of Directors may permit such conversion where the stock certificate has been lost or destroyed upon compliance with such conditions as the Board of Directors in its discretion may prescribe.

(c) Stock issued before the effective date of Title I of the Farm Credit Act of 1955 may be converted into class B stock or class C stock as agreed upon by the Bank and the holders of such stock in accordance with section 111 of the Farm Credit Act of 1955.

Section 6.—(a) Class A stock shall be retired at par, as provided in section 42 (a) (1) of the Farm Credit Act of 1933, as amended.

(b) After all class A stock has been retired, class B stock may be called for retirement at par, in full or on a pro rata basis, with the approval of the Farm Credit Administration, provided that the oldest outstanding class B stock at any given time shall be retired first, and provided that any holder of class B stock whose stock has been called for retirement may elect, with the approval of the Bank, to leave his stock in the Bank subject to its being included in the next call for retirement. The order of retirement of shares of class B stock shall be determined by the original date of issuance shown on the face of each certificate.

(c) After the retirement of all class A stock, class C stock may be retired at par by calling and retiring the oldest outstanding class C stock, in full or on a pro rata basis, but class C stock that was issued for a fiscal year period shall not be called for retirement until all class B stock that was issued during or prior to that fiscal year has been called for retirement.

Section 7.—Unless otherwise provided in the stock certificate, the Bank shall have a first lien on all stock in the Bank owned by any borrower as additional collateral for any indebtedness of the borrower to the Bank, except that in respect to any class C stock in the Bank which any cooperative association acquires on account of a direct loan to such association by the Central Bank for Cooperatives, the Bank's lien shall be junior to the lien of the Central Bank thereon.

Section 8.—(a) Certificates for class A stock shall be in a form prescribed by the Farm Credit Administration.

(b) Certificates for class B stock shall be in a form prescribed by the Board of Directors subject to the approval of the Farm Credit Administration.

(c) Unless otherwise provided by resolution of the Board of Directors, certificates shall be issued for class C stock and for stock issued before the effective date of Title I of the Farm Credit Act of 1955, but the ownership of any stock for which no certificate has been issued shall be confirmed by the Bank from time to time in accordance with regulations of the Farm Credit Administration and at any time at the request of the holder thereof or his representative. Certificates for any class of stock referred to in this subsection, if issued, shall be in a form prescribed by the Board of Directors subject to the approval of the Farm Credit Administration.

Section 9.—At the end of each fiscal year, and at such other times as may be prescribed by the Board of Directors or required by the Farm Credit Administration, the amount of impairment, if any, of the capital stock shall be determined by the Board of Directors.

Stipulation Exhibit 18-A

[iii] The fascinating story of the Banks for Cooperatives to date, is as intriguing to me as the change from oil lamps to electricity on our farms. Tomorrow's farmers and their cooperatives will require an even greater use of capital and credit. These banks, owned by the people they serve, will be one of our most useful tools in building that future.

J. K. STERN,

President, American Institute of Cooperation.

* * * * *

3 Not all the early history of the banks for cooperatives can be classified as pioneering, of course. Where possible, the banks naturally drew from the experience of others. Although the 13 banks were originally capitalized by the Federal Government, it was never their purpose nor intent, as agents of self-help to farmers, to loan Government money permanently. Instead, when it became feasible (in 1950), the banks tore a leaf from the book of other members of the family that go to make up the cooperative Farm Credit System and began obtaining much of their loanable funds through the sale of debentures (a form of secured bonds) to the investing public.

COOPERATIVES AND THEIR BANKS HAVE THRIVED.

5 Cooperatives have another strong incentive to borrow through the 13 banks. It gives them the opportunity to become part-owners in the banks. From the beginning borrowing cooperatives bought stock in the banks. However, it was not until the Farm Credit Act of 1955 that cooperatives really got on the road to eventual complete farmer ownership of the banks.

Naturally, the goal of member cooperatives is complete ownership. In just 4½ years, they have already retired \$32 million of this Government capital. In 1960 alone, \$8 million of the Government capital in the banks was retired. More complete details in the progress of member-ownership of the banks for cooperatives are given in a later chapter.

From hindsight, perhaps the history of the banks for cooperatives seems not so remarkable. But as you read the following chapters and learn more of the banks' origin from the lips of the men who lived it, the significance of the banks' accomplishments will take on new meaning. For those who by their current works are writing the history of cooperatives and figure to play a key role in the cooperatives of tomorrow, the following pages should build confidence. Although most of the problems cooperatives face today are quite different from those in 1933, they are every bit as vital and challenging—be they new methods of processing or marketing; or integration or merger; or whatever else may lie at the bend of the road ahead.

GOAL OF BANKS TO PROVIDE MORE THAN CREDIT

22 The new banks for cooperatives were not intended to promote cooperatives the way the Farm Board had done. However, from the beginning their goal was to provide counseling service to cooperatives along with sound business-type loans. For example, in his first report on activities of the St. Paul bank in 1934, President Hutzler Metzger, explaining the bank's objectives, said:

"The bank for cooperatives may be regarded as having two major functions: (1) that of distinct services to cooperatives; (2) the banking or credit function. It may be considered primarily as a service institution for the cooperatives of its particular district. Its purpose is to assist in building sound, well-managed, properly financed cooperative associations. Its lending function may be viewed as somewhat secondary in many respects."

BANKS COUNSELING WITH COOPERATIVES IMPORTANT

28 Many cooperative leaders would agree that the advice and counsel the banks for cooperatives have given individual cooperatives over the years along with their general educational programs have been as important as the actual financing they have furnished. This work has taken many forms and has covered almost every phase of cooperative endeavor. John E. Eidam, president of the Omaha Bank, reports for example:

"The bank for cooperatives, working with the colleges and with agricultural leaders, urged changes in corporate structure, financial policies, operating methods, and other sound practices to assure successful operations and effective services to members. The State of Iowa enacted a law in 1935 which provided for a revolving fund type of operation. This made it easier for creameries to establish retains. It also made it possible for grain elevators to retain net margins and thus build capital. Petroleum purchasing cooperatives and other farm supply cooperatives were able to use this same type of financing in order to build and make progress.

"Partly through the influence of the bank, cooperatives in the other States in the eighth district adopted the revolving

fund plan notwithstanding the fact that the laws were not specifically changed. This resulted in building capital and establishing cooperatives on a much sounder basis."

L. L. Ullyot, currently president of the St. Paul Bank for Cooperatives, reports some of the ways the educational programs tie into the actual lending functions:

"The bank has followed a relatively fast pay-out of the term loans. We believe this has enabled, and in some instances forced, so to speak, a number of borrowers to build net worth at a somewhat faster rate than they might have done under a more lenient repayment policy. Coupled with this the bank has also made it clear to the borrowers that it would give consideration to additional loans if satisfactory progress was being made."

Speaking at the 1959 annual meeting of the National Council of Farmer Cooperatives in, explaining this relationship Fred Merrifield, president of the Wichita Bank, said in part:

"The real reason, of course, for the existence of the banks for cooperatives, along with the other banks of the Farm Credit System is to assist individual farmers to better their position financially on their farms. This is being done by the banks for cooperatives indirectly through the marketing, supply, and service cooperatives owned by these farmers. In other words, our business is to keep the farmers' off-the-farm business with their cooperatives sound in order that cooperatives will assist these individual farmers to succeed in their own individual farm business. We believe it is the duty of the officers and business analysts of the bank for cooperatives to study, not only the operations of the most successful cooperatives, but also those who are having their trials, in order that we may assist all of our stockholders in a constructive way to continue to improve their operations.

BANKS MUCH LIKE PARTNERS

"This service must be rendered in a constructive and tactful manner in order that management of our cooperatives would not consider that bank officials are trying to dictate the running of their businesses. In other words, we must keep before our stockholders the fact that the banks for cooperatives are merely partners of the individual farmers in the local cooperatives, or of the local cooperatives in their regionals, from the standpoint of furnishing capital and working with their boards and officers

in promoting their growth and expansion plans. We believe that throughout the Nation, stockholders of the banks for cooperatives are appreciative of the service. We have tried to keep before the farmer-members of our cooperative stockholders the importance of ownership by them through investment in common stock or other permanent capital.

"The Wichita Bank for Cooperatives carries on a continuous educational program, working with the State land-grant colleges and particularly with the State cooperative councils."

The situation in the areas served by the other district banks for cooperatives was much the same. John Eidam, as president of the Omaha bank and long associated with the System in reporting in 1959 recalls:

"In the early 30's, this 4-State area was the home of considerable numbers of cooperative grain and dairy marketing associations. Farm supply cooperatives were as yet largely undeveloped. Not only was this a period when the Nation's economy as a whole, but agriculture in particular, was at a low ebb. The cooperative organizations were for the most part small and financially weak. Under such circumstances, it was inevitable that many of the farmers' elevators and cooperative creameries were engaged in a desperate struggle for existence."

The New Orleans bank (serving cooperatives in Alabama, Louisiana and Mississippi) provides an excellent example of how the bank's counseling has helped farmers organize and develop strong cooperatives to serve them. When the banks were organized, cooperatives in most areas were crying for loans. But in the New Orleans District, the opposite was true—there just weren't many cooperatives.

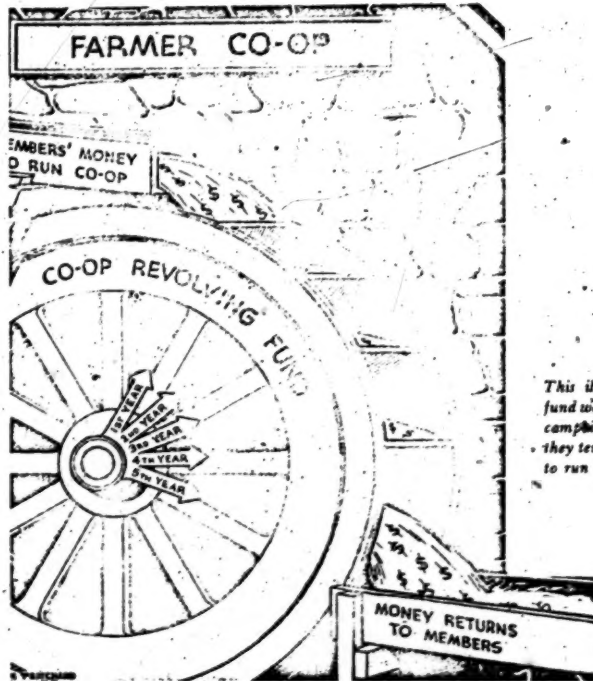
HELP FARMERS BUILD NEW CO-OPS

Under the able leadership of H. O. Pate, former president, and President E. F. Chavanne, cooperatives in that District have grown considerably over the years in members and strength. Only 16 of the 137 current borrower-members of the bank were even in existence in 1933 when the bank was organized. The bank has been particularly helpful in assisting farmers develop sugar, rice, cotton and farm supply cooperatives in the three State area. In 1934, thirty-seven associations borrowed just over \$1 million. In 1960, 74 cooperatives borrowed over \$23 million from the New Orleans bank.

The Louisville Bank for Cooperatives provides an illustration of other financial services the banks have performed of benefit to farmers in addition to their regular direct loans to cooperatives. President J. Kenneth Ward points this up in reporting on how the Louisville bank has acted through the years as a servicing agent for Commodity Credit Corporation's tobacco support program:

"Since 1943, the bank has acted as agent for CCC. Under this program, advances are made direct to associations on tobacco going under the support program. The bank is reimbursed for the funds advanced by drawing a draft on CCC. All records, warehouse receipts and other documents are maintained by the bank."

[32]



This illustration of how a co-op revolving fund works was widely used in the educational campaign to teach farmers how the money they temporarily invested provided the power to run their associations.

* * * * *

DEVELOPING FARMER OWNERSHIP

41 Complete farmer-ownership and control of the cooperative Farm Credit System was recognized as a goal for all the banks and associations from their very beginning. Congress said as much when it passed the Federal Farm Loan Act of 1916, setting up the 12 Federal land banks and national farm loan associations (now Federal land bank associations). The Act enabled the associations to be completely farmer-owned. It also provided for the Federal land bank associations to use the money farmers invested in their stock to purchase stock in the Federal land banks, and thus gradually replace the Government-owned stock in the banks.

FARM CREDIT ACTS SET COURSE

The only exceptions to the rule of some farmer-ownership in all parts of the cooperative Farm Credit System in their original authorizing legislation was in the cases of the Federal intermediate credit banks in 1923 and the production credit corporations in 1933. These exceptions were corrected in the Farm Credit Act of 1956 which merged the production credit corporations into the Federal intermediate credit banks, and launched a plan for the merged banks to become owned by the farmer-owned production credit associations.

While Myers was Governor of the Farm Credit Administration (from November 1933 to 1938), he stressed the aim of building a permanent farmer-owned system many times.

FARMER OWNERSHIP THE GOAL

According to Myers, the goal was that this System should have control as well as ownership by farmers. This farm ownership in the banks for cooperatives, he said, would be through the farmers' ownership of stock in their local marketing, purchasing and farm service cooperatives which, in turn, would own the stock of the banks.

From the beginning in 1933, each borrowing cooperative because of its ownership of capital stock in the bank, had a vote in

electing one director to the Farm Credit district board. The Farm Credit Act of 1933, as mentioned earlier, provided for borrowing cooperatives to buy capital stock in proportion to their loans.

Myers points out that because of the loss experience of the Federal Farm Board (in its price stabilization operations), cooperative leaders intensely distrusted the future soundness of the banks. Thus they did not want to keep funds of their cooperatives invested in the banks' capital stock after they repaid their loans in full. Thus, the law provided that their stock in the banks could be retired when their loans were fully repaid. Most of the cooperatives took advantage of this provision. Thus, the law did not encourage patrons to acquire full ownership of the banks.

DEPRESSION POSED PROBLEMS

The first big problem at the time the banks were organized was solving the emergency situation caused by the Depression. This work took the time and energy of those in charge for the first few years. Many of the refinements needed to make the System truly cooperative had to wait until later.

It was not surprising that S. D. Sanders, when he took over as Cooperative Bank Commissioner in 1936, should take a critical look at the way the banks were capitalized. He had long been interested in farmers increasing their ownership of cooperatives by the use of the revolving fund plan of financing. He wondered if this plan also wasn't suitable for financing the banks for cooperatives. Most of the capital in the banks, however, was owned by the Government. The money used for this purpose was that remaining in the Agricultural Marketing Act Revolving Fund of \$500 million from which the Farm Board had made loans to farmers' cooperatives and to stabilization corporations. At its peak between 1945 and 1954 the amount invested in the banks from the Fund was \$178.5 million.

EVOLVE PLAN TO RETIRE GOVERNMENT STOCK

Shortly after Mr. Sanders took office, there was a meeting of the presidents of the banks for cooperatives in Washington, D.C. Mr. Sanders was anxious to get the ideas of these officers. He threw out ideas to them and listened to their discussions on all phases of their problems. One spirited discussion came about when he asked the question:

"What would you gentlemen think of the advisability (when conditions are right) of having the law amended whereby the stock would remain in the hands of the borrower and be divided into two series—A and B; the A series being the government stock and the B series the cooperative's stock, with dividends paid on the B stock which would be looked upon as an investment by the cooperative. By paying a reasonable dividend on that stock, we might look forward to the time when the cooperatives own a large percent of all the stock and the Government money gradually would be retired."

Mr. Sanders went on to say that often directors of farmers' cooperatives had asked him why the farmers and cooperatives borrowing from the System didn't elect more of the directors instead of having them appointed by the Governor of the Farm Credit Administration. He reminded them that ownership and control went together and that once farmers and the cooperatives owned the System, or a larger share of the capital stock, they could expect to elect a majority of the directors.

REVOLVING FUND PLAN SUGGESTED

E. A. Stokdyk, then president of the Berkeley Bank, asked Mr. Sanders if the class B stock plan he suggested would be put on a revolving fund basis. Mr. Sanders said "Certainly—it is the most equitable way in the world for farmers to finance their own institutions."

Some of the presidents doubted that the plan would work. As one president said, the members of the cooperatives in his district "want all of the control and want everything delivered to them and they give nothing." They had this attitude
43 toward both their local cooperative and the bank for cooperatives.

To this Mr. Sanders said: "In my way of thinking the philosophy of those men is very unsound all the way through. All interested in the farmers' welfare must recognize that no one on earth is going to change the status of the farmer but the farmer himself, and must realize that the bank for cooperatives is a business institution and requires capital, and furthermore that the capital must be furnished by the farmers (through their cooperatives) if they expect to have control of their credit system. That is just good common sense."

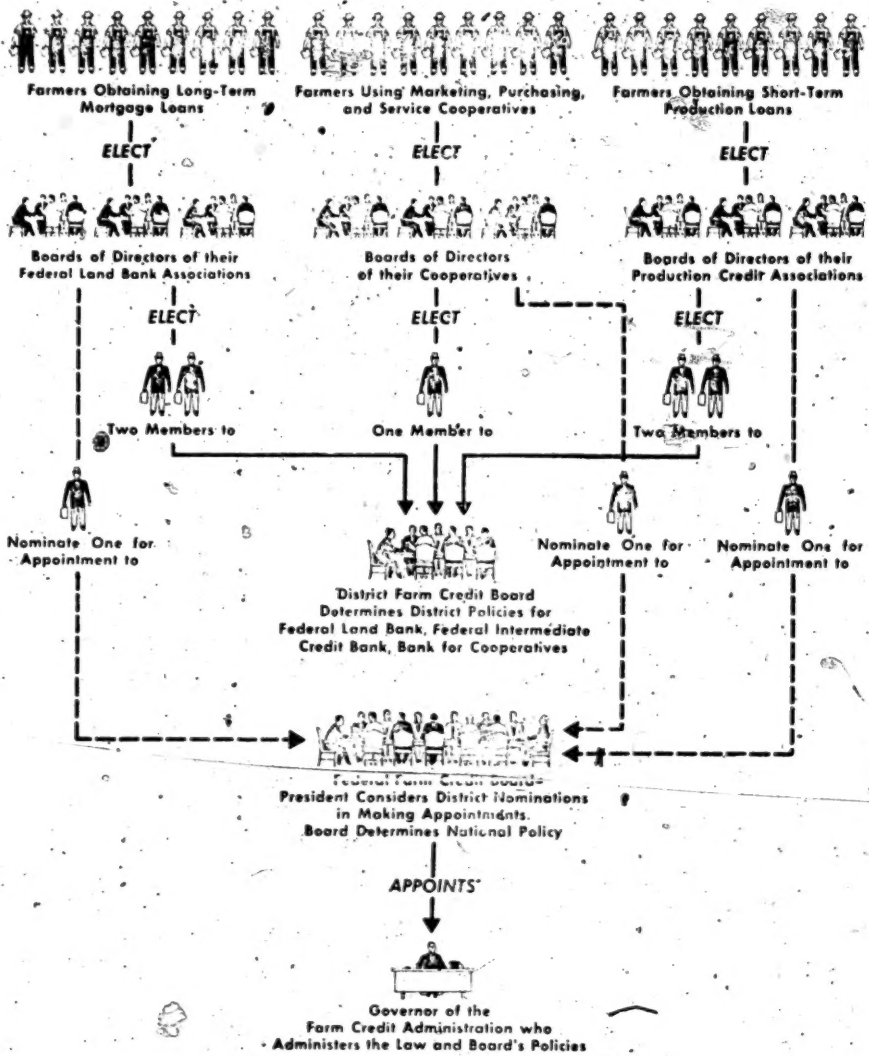
However, the representative of the Houston Bank for Cooperatives, President Sterling Evans, said that associations "that repay their loans are very much inclined to keep their stock in the bank."

The subject was brought up again at the next conference of presidents in December 1936. A tentative draft of a suggested amendment to rearrange the capital structure of the banks for cooperatives was submitted at the meeting. The plan provided for three classes of stock. Class A stock would be owned by the Government. The class B stock bought on account of loans would not be retired when loans were repaid but would be revolved out after 5 years. Class C stock would be, in effect, an allocation of earnings retained to build net worth.

In discussing the suggested amendment, Mr. Sanders said the thought was gradually to retire the Government capital, by replacing it with cooperatives' capital, thereby giving an inducement to the cooperatives to assume their part in building this capital structure.

[44]

How Farmers in each of 12 Districts Share in Control of Cooperative Farm Credit System



EMPHASIZE COOPERATION

45 A. S. Goss, then Land Bank Commissioner and later Master of the National Grange, who was at the meeting, said that the whole System must work together toward building up a strictly cooperative farm credit system.

Even at that time, the more progressive farmers' cooperatives were taking an interest in owning the banks. At the annual stockholders' conference of the Louisville Bank for Cooperatives, held on October 26, 1937, a resolution was passed requesting the National Cooperative Council (later the National Council of Farmer Cooperatives) "to study this problem and work out the details of such a plan . . . so that it can be submitted to Congress for action at an early date." This was spearheaded by M. J. Briggs, later general manager of the Indiana Farm Bureau Cooperative Association and at that time a member of the Farm Credit Board of the Louisville district.¹

WAR POSTPONES PLANS

The early efforts to change the capital structure of the banks were interrupted by the more urgent needs of building our defense and later by the war. The banks for cooperatives were serving cooperatives adequately at the time and most cooperatives and others saw no reason for making changes.

It was not until plans for the postwar period were underway that changing the capital structure of the banks again received active attention. The banks were being criticized for using Government capital.

Farmers and farmers' cooperatives brought the matter up at meetings of their farm organizations. So urgent was the demand for changes in the entire Farm Credit System that in 1943 the National Grange, American Farm Bureau Federation, and

¹ Briggs also later served as a member of the Central Bank Board and for several years as chairman of the committee on farm credit legislation of the National Council of Farmer Cooperatives. He has since served as a member, vice chairman, and chairman of the Federal Farm Credit Board created by the Farm Credit Act of 1953.

National Council of Farmer Cooperatives, set up a joint farm credit committee. Mr. Goss, by then Master of the National Grange, headed the committee. This committee worked on developing plans for improving the cooperative aspects of the entire Farm Credit System.

At that same time, Stokdyk worked up a plan for a new capital structure for the banks for cooperatives, based on the Berkeley bank's experience, and sent it to the other presidents. He suggested that they work up similar plans.

At the meeting of the presidents in February 1944, Stokdyk asked that a study be made of capital that the banks would have accumulated since organization under various alternative plans. This study was later made.

A committee of bank for cooperatives presidents consisting of Stokdyk as chairman, H. O. Pate (New Orleans); and Hutzler Metzger, (St. Paul) was appointed by Sanders to develop practical suggestions on the capital structure of the banks. It held its first meeting in Kansas City on February 2 and 3, 1945. At that meeting the tentative plans suggested for the capitalization of the banks were discussed. They later became the basis for proposals which ultimately resulted in the Farm Credit Act of 1955.

STUDY CAPITAL REQUIREMENTS

A real step forward was taken at the conference of banks for cooperatives' presidents held in August 1947. This meeting was taken up mostly with discussions of the capital requirements of the banks.

The current capital committee of D. M. Hardy (St. Louis); Pate, and Metzger, presented a report which included

- 46 specific recommendations.

Almost an entire day was taken to examine the views and counsel of leaders of cooperatives and general farm organizations on the problem of gradually converting the banks for cooperatives into truly cooperative institutions.

SEEK VIEWS OF FARM ORGANIZATIONS

Goss, as Master of the National Grange, gave his views on various phases of the capitalization plans under review. Others who made suggestions and comments were: Charles H. Holman, Executive Secretary, National Cooperative Milk Pro-

ducers Federation; H. Willis Tobler, Assistant to the Director, American Farm Bureau Federation; John J. Riggle, Director of Cooperative Services, National Council of Farmer Cooperatives; John Brandt, President, National Milk Producers Federation and Land O'Lakes Creameries, Inc.; F. V. Heinkel, President, Missouri Farmers Association; Roy F. Hendrickson, Washington representative, National Federation of Grain Cooperatives; and W. G. Wysor, General Manager, Southern States Cooperatives, Inc.

These farm leaders were definitely in favor of the immediate development of a comprehensive plan for increasing farmer cooperative ownership of the banks for cooperatives. They were willing to accept the responsibility of selling the program to farmers and farm groups and to sponsor any legislation needed.

A committee of three presidents of banks for cooperatives, Hutzler Metzger, A. C. Adams (Spokane) and Lindsay Crawford (Berkeley) was appointed to stay after the conference to work on a tentative plan.

In February 1948, hearings were held by the House Committee on Agriculture on a bill to provide for the retirement of the Government capital in the banks for cooperatives. This bill had been drafted by a committee representing the American Farm Bureau Federation, the National Grange, the National Cooperative Milk Producers Federation, the National Federation of Grain Cooperatives, and the National Council of Farmer Cooperatives.

Congressman Clifford R. Hope introduced the bill in the House on April 21, 1948, and on May 29, the House Committee on Agriculture reported it with "a recommendation that it do pass." A companion bill was introduced in the Senate by Senators Arthur Capper and George D. Aiken. Hearings were held. In addition to the farm organizations which had drafted the original House bill, the National Farmers Union and several additional cooperative organizations gave testimony in favor of the Senate bill.

Again at the next session of Congress on January 5, 1949, Congressman Hope introduced a bill very similar to that considered in the previous Congress. Hearings were held and the bill was passed by the House. It was then referred to the Senate but no action was taken during that session.

M. J. Briggs, Chairman of the Agricultural Credit Committee of the National Council of Farmer Cooperatives in his 1951 report said: "The national farm and cooperative organizations decided that it (was) preferable that more general farm credit legislation precede the Banks for Cooperatives Bill. . . ."

PASS FARM CREDIT ACT OF 1953

The more general farm credit legislation referred to was enacted as the Farm Credit Act of 1953. The Act stated: "It is declared to be the policy of the Congress to encourage and facilitate increased borrower participation in the management, control, and ultimate ownership of the permanent system of agricultural credit made available through institutions operating under the supervision of the Farm Credit Administration, and the provisions of this Act shall be construed in keeping with this policy."

The Act made several important changes chief of which were:

47. It established the Farm Credit Administration, which had operated from 1939 to 1953 as a part of the U.S. Department of Agriculture, as an independent agency of the executive branch of the Government.

FEDERAL FARM CREDIT BOARD CREATED

A 13-member part-time policy-making Federal Farm Credit Board was created to exercise general direction and supervision over the performance of all functions, powers, and duties vested in the Governor when relating to matters of a broad and general supervisory, advisory, or policy nature. Twelve of the members of the Board are appointed by the President of the United States subject to confirmation by the Senate for 6-year terms. Members who have served a full 6-year term are not eligible for reappointment. The 13th member of the Board is appointed by the Secretary of Agriculture as his representative to serve at his pleasure.

In making his appointments, the Act directs the President to give consideration to the three nominees designated by the production credit associations, the Federal land bank associations, and farmers' cooperatives borrowing from the bank for cooperatives in each Farm Credit district, respectively.

BOARD IS BIPARTISAN

The sponsors of the legislation wanted to confine the President's appointments to one of the three nominees in each district. However, constitutional lawyers felt the President could not be limited to that extent. Congressman Harold Cooley, in agreeing to the change, said he did so because he had such confidence that the incumbent of the White House would carry out the original intent of Congress. Up to this time (June 1960), the President has limited his appointment of all Board members to these nominees. Thus, the farmer-members
48 who own and use the System have, since 1953, had a voice in making policies at the national level.

The Federal Farm Credit Board selects the Governor of the Farm Credit Administration as its administrator to carry out its policies and the duties prescribed by law. As long as there is any Government capital in the system the President of the United States must approve the appointment.

This act abolished the offices of Commissioners—Cooperative Bank Commissioner, Production Credit Commissioner, Land Bank Commissioner, and Intermediate Credit Commissioner—which were appointments made by the President and confirmed by the Senate. Subsequently the duties of these Commissioners were assigned to a director of each of three credit services appointed by the Governor. These directors of Cooperative Bank Service, Short-Term Credit Service, and Land Bank Service, are also designated as deputy governors.

The act also required the Federal Board to make recommendations to Congress on means for eventually retiring the remaining Government capital in the Farm Credit System.

PASS FARM CREDIT ACT OF 1955

The Farm Credit Act of 1955 provided a comprehensive plan for the cooperatives using the services of the banks to build up their investment in these banks and for the gradual retirement of the Government-owned capital. The act provided for three classes of capital stock—A, B, and C. Existing Government-owned stock was transferred to class A. Cooperatives and others can invest in class B stock, on which dividends of 2 to 4 percent are paid. Cooperatives buy class C stock in connection with their loans and receive patronage refunds in class C

stock from the bank's savings in proportion to the interest they have paid during the year.

Upon retirement of all Government capital, except for any class B stock held by others, the Central Bank for Cooperatives will be owned by the district banks for cooperatives and the district banks will be owned by the cooperatives that use the banks.

MOVING TOWARD FARMER OWNERSHIP

Under the Act, complete ownership by the cooperatives will be accomplished by retiring Government-owned (class A) stock in each bank annually in an amount substantially equivalent to the class C capital stock acquired by borrowers during the year.

Borrowers acquire class C capital stock: (1) by purchasing at least one qualifying (voting) share; (2) by investing regularly in such stock a certain required percentage (from 10 to 25 percent) of the amount of interest they pay on their loans from the bank (10 banks are requiring 15 percent, and 3 banks 20 percent); and (3) through patronage refunds paid in the form of such stock from part of the banks' annual net savings, and by distribution of surplus previously allocated to borrowers upon a patronage basis.

Class B and C stock can be revolved by paying off the oldest outstanding shares after all Government stock has been retired, but class C stock issued for a fiscal year period may not be retired until all class B stock issued during or prior to that fiscal year has been called for retirement.

Because of the provision in the original Act that upon repayment of the loans, borrowers had the right to have their stock retired and receive the proceeds either in cash or applied as the final payments of their loans, only \$20.6 million of capital stock was owned by cooperatives on December 31, 1955. And even this could not be regarded as permanent borrower capital.

The Farm Credit Act of 1955 (which went into effect January 1, 1956) provided an opportunity for the then current stockholders to convert their stock to new class B and class C stock and to convert their existing loans to conform to the provisions of the Act. Thus they would agree to make regular purchases of class C stock based on the amount of their interest payments. Cooperatives responded exceed-

ingly well to this responsibility. Eighty-three percent of the cooperatives voluntarily converted their existing loans to the new basis. Over 90 percent of the old stock owned by cooperatives on the effective date of the Act was voluntarily exchanged for new class B or C stock. The cooperatives could have requested payment for the old stock when they paid off their loans.

The Farm Credit Act of 1955 also provided for certain changes in the Central Bank for Cooperatives.

CONSIDERABLE PROGRESS MADE

Cooperatives have made excellent progress toward complete member ownership of their banks in the 4½ years they have been operating under the 1955 Act. Ownership of capital stock, in the banks by cooperatives, has increased from \$20.6 million to \$45.9 million on June 30, 1960. In addition, surpluses of \$10.1 million have been accumulated and allocated to patrons. Of the total capital stock cooperatives have invested in the banks, \$14.9 million was purchased as class C stock; \$16.7 million was acquired as patronage refunds in class C stock; \$14.0 million was class B stock voluntarily invested; and \$253,000 was capital stock acquired before the Farm Credit Act of 1955 which was not converted to the new stock. The banks paid \$445,548 in dividends on class B stock during the fiscal year ended June 30, 1960.

Prior to this act, six of the seven directors of the Central Bank for Cooperatives were appointed by the Governor of the Farm Credit Administration, three from among nominees of the borrowing cooperatives. The seventh member and chairman of the board was the Director of Cooperative Bank Service (previous to 1953 Cooperative Bank Commissioner) who also served as chief executive officer of the bank. Under the 1955 Act no officer or employee of the Farm Credit Administration may serve as chief executive officer or as a director of the bank.

Beginning January 1, 1957, the Governor appointed only four of the seven directors of the bank, and three are elected by farmer cooperatives and district banks for cooperatives. Three of the appointed directors were subject to being succeeded by elected directors when the total of patrons

investment in stock and the reserves and surplus of the bank, was equal to two-thirds of the bank's net worth.

An amendment in 1960 increased the board of directors to 13. Starting January 1, 1961, one will always be appointed by the Governor of the Farm Credit Administration. Eventually each district bank will elect a director. However, until the banks meet the stock ownership requirement mentioned in the preceding paragraph, only six district banks will elect directors and the other six directors will be appointed by the Governor. The district banks will alternate in electing directors until that condition is met.

As now constituted the Central Bank's board of directors functions in the same manner as a district bank's board in determining policies and electing the bank's officers.

The 1953 Act had already broadened farmer control at the district level by giving farmer-members, through the boards of directors they choose to run their credit and other cooperatives, the authority to elect a larger number of members of the district Farm Credit boards.

ELECT ALL BUT TWO BOARD MEMBERS

Formerly, three members of each district board of seven members had been elected—one each by national farm loan associations, production credit associations, and borrowers from the banks for cooperatives. The Governor of the Farm Credit Administration appointed the other four members, one of whom had to be appointed from a list of three nominees of the national farm loan associations of the district.

Under the Farm Credit Act of 1953, production credit associations and Federal land bank associations in each district, each elect two members of the district Farm Credit Board, as they meet the requirements of farmer-ownership set out in the Act. Cooperatives using the bank for cooperatives currently elect one member but may elect a second member when they meet similar requirements of investment in the ownership of their respective bank for cooperatives. The requirements are the same as those for the Central Bank mentioned previously.

The other two members of each district board—eventually only one—continue to be appointed by the Governor of the Farm Credit Administration with the advice and consent of the Federal Farm Credit Board.

LOOK TO THE FUTURE

There is still considerable distance for the cooperatives to travel. However, they have been making splendid progress toward the goal of complete farmer-ownership of the banks for cooperatives since the passage of the 1955 Act. They are confident they can complete the job within a reasonable time.

Passage of the 1955 Act proved to be a great morale booster for those associated with the banks. President Homer G. Smith, Central Bank for Cooperatives, mentions this in a letter of January 19, 1960:

"Since enactment of the legislation, the banks are operating in a new atmosphere and as new organizations. This can be observed by attending stockholders' meetings of the banks across the Nation. At these meetings there is emphasis on the future of the banks as farmer cooperatives; how they can better serve farmers; and how they are progressing toward complete farmer ownership."

The 1955 Act set up some goals for the banks to shoot at and, as their experience so far has shown, these goals are attainable.

SOURCE OF FUNDS

51 When the banks for cooperatives were established in 1933 and 1934 at the depths of a depression, it was highly important that they should start operating as soon as possible. The banks needed two things: underlying capital and loan funds.

In the case of the other parts of the cooperative Farm Credit System, Congress had provided original underlying capital in the form of Government-owned stock. Congress had also made it possible for the users of these banks and associations, except in the case of the Federal intermediate credit banks, to buy stock in connection with their loans, plus providing a means

of going to the investment markets for loanable funds. Congress followed this same pattern in enacting legislation for the banks for cooperatives.

EXPAND CAPITAL STOCK

The Government funds to purchase capital stock in the banks for cooperatives came from the Agricultural Marketing Act Revolving Fund which had been used by the Federal Farm Board in making loans to farmers' cooperatives and for stabilization purposes, as explained in detail in earlier chapters. The original stock provided was \$110 million.

As the banks grew in size and the cash available in the Revolving Fund increased, the Governor of the Farm Credit Administration subscribed and paid for additional amounts of capital stock. The peak investment was \$178.5 million, as shown in the table below.

Capital Stock of Banks for Cooperatives

June 30	Government capital stock (millions)	Farmer-owned stock (millions)
1935	\$125	\$1.4
1940	149.0	3.4
1945	178.5	5.5
1950	178.5	14.1
1955	150	18.3
1960	118.3	45.9

At first the banks had sufficient capital to make loans without borrowing additional funds. From the beginning the banks for cooperatives could discount short-term loans with the Federal intermediate credit banks. As mentioned on page 25, this means of financing was widely used for commodity loans during some of the early years. However, throughout most of their history, the banks have borrowed from commercial banks to obtain funds to supplement their capital which includes Government-owned stock and capital stock supplied and owned by cooperatives and their surplus and reserves. Many of the Nation's largest commercial banks have been extremely helpful in this regard.

Stipulation Exhibit 18-B, page 7

MANY SERVICES

The principal function of a Bank for Cooperatives is to make available a lending service geared to the needs of farmer cooperatives. However, closely allied to this is a secondary objective—that of rendering a general business service to borrowers.

For the most part, the business services rendered are of an advisory and counseling nature. Because the Bank specializes in the field of financing farmer cooperatives, the general experience gained from such specialization is often useful to individual cooperatives.

Within the limitations of its staff, a Bank will work with any farmer cooperative in the district, whether a stockholder or not, when requested to do so. Examples of the areas in which an advisory service might be performed would include budgeting, long range financial planning, operating trend analysis, credit policies, and auditing standards. In regard to services which involve legal matters, the Bank's attorney may, if requested, work in an advisory capacity with counsel for the cooperative.

It is a function of the Bank to be genuinely and sympathetically interested in the formation of sound, well-organized cooperatives wherever the need exists and farmers can be better served.

Similarly, the Banks stand ready to consult with borrowers on the advantages of mergers and consolidations and other matters of concern to the borrower's future operations. They also participate in various training programs for directors, managers and for other cooperative personnel. In short, the Banks for Cooperatives provide farmer cooperatives a complete and specialized credit service which gives the money they lend extra value.

10

ORGANIZATION OF THE BANKS

As mentioned earlier, the Banks for Cooperatives are a part of the farmer-owned cooperative Farm Credit System. Located at the same point in each of the 12 Farm Credit Districts are a Federal Land Bank and Federal Intermediate Credit Bank, as well as a Bank for Cooperatives.

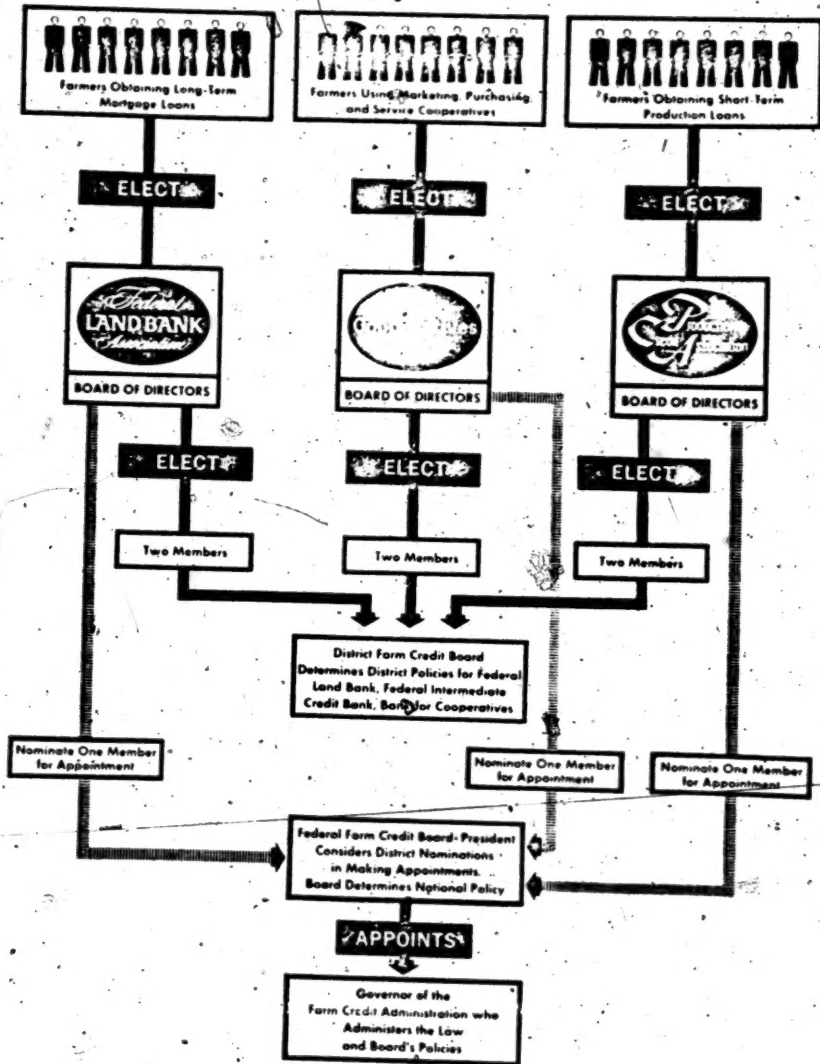
The cooperatives owning stock in a district Bank elect two of the seven members of the district Farm Credit Board which serves as a board of directors for all three Farm Credit Banks in the district. The Production Credit Associations elect two members and the Federal Land Bank Associations elect two members to each district board. The seventh member is appointed by the Governor of the Farm Credit Administration, with the advice and consent of the Federal Farm Credit Board.

The board of directors of the Central Bank for Cooperatives consists of 13 members, one from each of the 12 Farm Credit Districts and a director-at-large. The board of directors of each district Bank for Cooperatives elects a member of the board of directors of the Central Bank. The director-at-large is appointed by the Governor of the Farm Credit Administration, with the advice and consent of the Federal Farm Credit Board.

* * *

[11]

How Farmers Share in Control of Cooperative Farm Credit System



Just as commercial banks have Governmental supervision, so do the Banks for Cooperatives. The Farm Credit Administration, an independent agency of the Federal Government, coordinates and supervises the banks and associations of the Farm Credit System:

Although a Government agency, all expenses of the Farm Credit Administration are assessed against the various banks and associations that make up the cooperative Farm Credit System.

Farmers and their cooperatives also have a voice in the control of the Farm Credit Administration. A 13-member,

12 part-time Federal Farm Credit Board sets the policies under which the Farm Credit Administration operates, and also appoints the agency's executive officer—its Governor. Twelve members of the board—one from each district—are appointed to 6-year terms by the President of the United States. However, in making the appointments from each district, the President considers persons who are nominated by the Production Credit Associations, Federal Land Bank Associations and by cooperatives which use the Banks for Cooperatives. The thirteenth member of the board is appointed by the Secretary of Agriculture as his representative. Thus, in Banks for Cooperatives, and in the entire Farm Credit System, the emphasis is on a democratic, cooperative organization. The System is in business to assist farmers financially and is designed to assure this objective:

13 In the ebb and flow of agricultural revolution, predictions of any sort not only are risky, but more than a little complicated. As a case in point, one cannot speculate on the future of the Banks for Cooperatives without first considering the prospects of the farmer cooperatives they serve. Nor, for that matter, can one ignore the prospects of the ultimate gainer or loser in all of this—the American farmer.

Exhibit 19-H

III

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FARM CREDIT ADMINISTRATION

FEDERAL FARM CREDIT BOARD

V.

JULIAN B. THAYER,
Middlefield, Conn.
 WILLIAM T. STEELE, Jr.,
Richmond, Va.
 MARSHALL H. EDWARDS,
Bartow, Fla.
 MARVIN J. BRIGGS,
Indianapolis, Ind.
 J. PITTMAN STONE,
Coffeeville, Miss.
 L. C. CARTER,
Stuttgart, Ark.

JOE B. ZEUG,
Walnut Grove, Minn.
 J. B. FULLER,
Torrington, Wyo.
 GEORGE W. LIGHTBURN,
Capron, Okla.
 FRANK STUBBS,
Corpus Christi, Tex.
 GLEN R. HARRIS,
Richvale, Calif.
 ROBERT T. LISTER,
Prineville, Oreg.

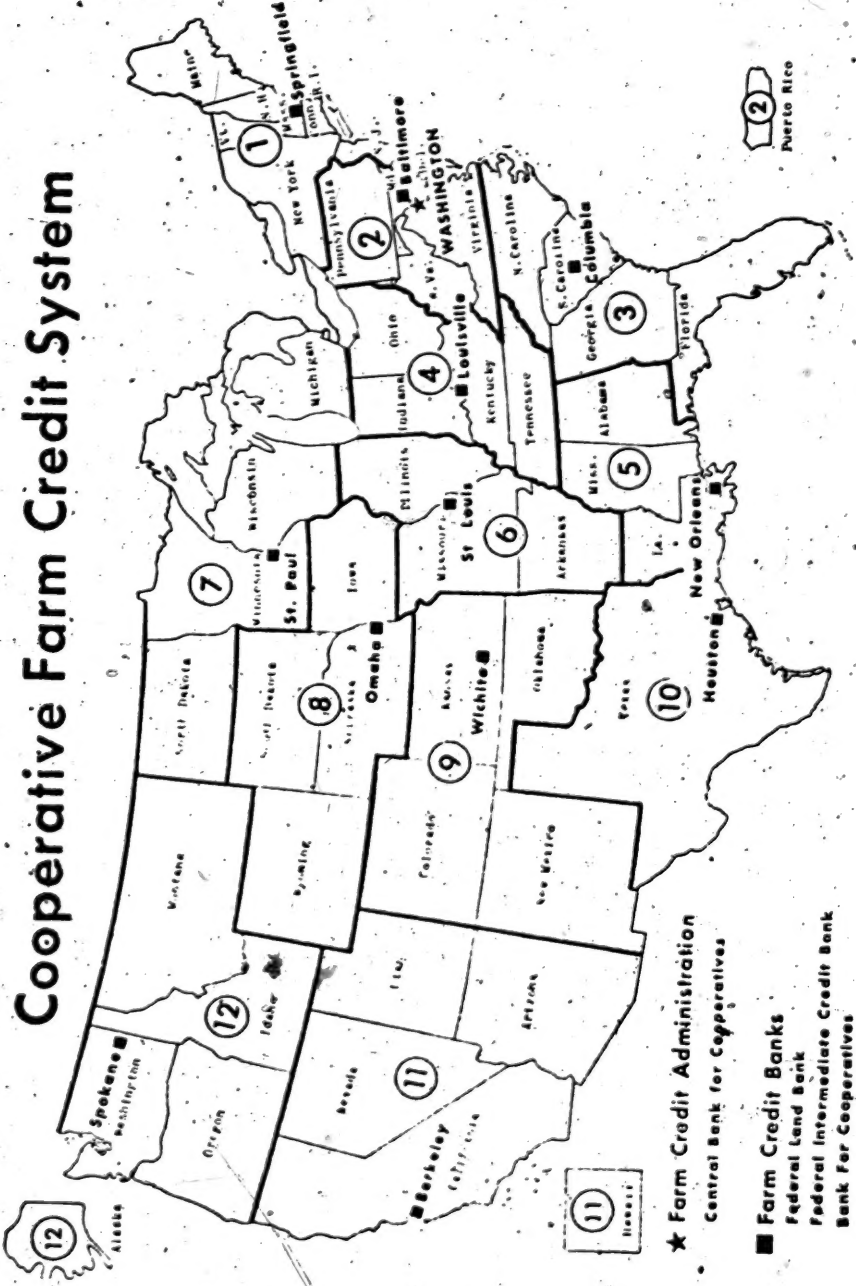
MURRAY D. LINCOLN, *Columbus, Ohio*
 Officers

FRANK STUBBS—*Chairman*
 J. PITTMAN STONE—*Vice Chairman*
 J. MAHLON SELBY—*Secretary*

Administrator

ROBERT B. TOOTELL, *Governor*.

Cooperative Farm Credit System



[vi]

30th Annual Report of the

FARM CREDIT ADMINISTRATION

The banks and association of the cooperative Farm Credit System this year again set new records in service to farmers and their marketing, purchasing, and business service cooperatives as well as in farmer investment in the System.

Farmers and their cooperatives borrowed \$5.3 billion from the cooperative Farm Credit System in the year ended June 30, 1963. This was nearly 12 percent more than in the previous year.

Loans which farmers, ranchers, and cooperatives had outstanding on June 30, 1963, totaled \$6.3 billion and exceeded by 10 percent the amount outstanding a year earlier.

About 18 percent of the total credit farmers and ranchers were using on January 1, 1963, came from the cooperative Farm Credit System. Farmers' marketing, purchasing, and business service cooperatives are estimated to obtain about 60 percent of the credit they use from the 13 banks for cooperatives.

Celebrate Anniversaries

This year marked several anniversaries in the System. It marked the 30th year that the Farm Credit Administration, established by Executive order in 1933, has supervised the System. Created by the Farm Credit Act of 1933, it is also now 30 years since the production credit associations and banks for cooperatives began operations. The 12 Federal intermediate credit banks began operations in 1923, created by the Agricultural Credits Act of 1923, and are, therefore, celebrating their 40th anniversary. The 12 Federal land banks and Federal land bank associations, created by the Federal Farm Loan Act of 1916, are the oldest of the System. They began operations in 1917.

System Serves All Credit Needs.

The cooperative Farm Credit System, supervised by the Farm Credit Administration, provides all types of credit needed by farmers and their cooperatives. Farmers obtain farm mortgage loans from 763 Federal land bank associations and 12 Federal land banks. These associations and banks are completely farmer-owned. Land bank loans are used principally to finance the purchase of farms and additional farm land, for buildings and improvements, to refinance debts, and for other agricultural purposes.

The 487 production credit associations, which obtain their lending funds from the 12 Federal intermediate credit banks, provide a system of short and intermediate term farm operating credit. Farmers use these loans for 1 year or less to finance seasonal operating expenses, for family living, and for other farm expenses. They also borrow, for periods up to 7 years, for such farm capital needs as the purchase of farm machinery, livestock, and farm improvements.

The 13 banks for cooperatives provide a complete system of credit for farmers' marketing, purchasing, and business service cooperatives. They make commodity, operating capital, and facility loans.

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FEDERAL FARM CREDIT BOARD

The Federal Farm Credit Board, a 13-member, part-time policymaking Board, directs, supervises, and controls the Farm Credit Administration. The Board met six times during the year. All meetings were held in Washington, D.C.

Twelve of the members of the Board, one from each Farm Credit district, are appointed by the President of the United States, with the advice and consent of the Senate, for 6-year terms. Members are not eligible for reappointment after serving a full 6-year term. The President is required by law, in making these appointments, to consider nominations from each Farm Credit district made by Federal land bank associations, production credit associations, and farmers' marketing, purchasing, and business service cooperatives which are stockholders of the district bank for cooperatives. Presidential appointments have all been from nominees of these three

groups. The Secretary of Agriculture designates the 13th member of the Board who serves at the Secretary's pleasure.

The names of the 13 members of the Board are shown on page v.

At its 1963 organization meeting, the Board elected Frank Stubbs as its chairman and J. Pittman Stone as vice chairman. J. Mahlon Selby was reelected secretary.

During the year, the Board approved the appointments by the Governor of the Farm Credit Administration of two members of the board of directors of the Central Bank for Cooperatives.

Again, as in previous years, to keep more fully advised on matters pertaining to agriculture, the Board met with various groups and representatives of groups. These included the national advisory committees of the production credit associations and Federal land bank associations; an Oklahoma congressional delegation; J. K. Stern, president, American Institute of Cooperation; and Roy F. Hendrickson, executive secretary, National Federation of Grain Cooperatives.

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GOVERNOR'S OFFICE

The Governor is the chief executive officer of the Farm Credit Administration. He is appointed by the Federal Farm Credit Board to administer the law and carry out the Board's policies and is responsible to the Board for administering all the powers, functions, and duties of the Farm Credit Administration in supervising the cooperative Farm Credit System. He informs and consults with the Board on matters of a broad and general supervisory, advisory, or policy nature, and is subject to the Board's decisions and supervision.

As in previous years, the Governor kept the Federal Farm Credit Board informed between its regular meetings on activities of the Farm Credit System and other matters of importance in the fields of farm credit and agriculture.

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The *Cooperative Bank Service*, headed by a director who is also a deputy governor, supervises and coordinates the operations of the 13 banks for cooperatives—12 district banks and the Central Bank—which provide an esti-

mated 60 percent of the credit used by farmers' marketing, purchasing, and business service cooperatives.

The service keeps in close touch with the credit needs of farmers' cooperatives and works with officials of the banks for cooperatives in improving and adapting their credit service to meet changes in modern agriculture. By constantly reviewing and analyzing the operations of the banks, this service is able to advise and counsel with officials on how best to increase their usefulness and effectiveness. An important part of its work is conducting conferences and participating in management training programs.

The service coordinates the borrowing and lending programs of the banks. It reviews and analyzes certain loans submitted by the banks. It issues rules and regulations to guide the banks in making loans in accordance with the provisions of the laws under which they operate. It also reviews and makes recommendations to the Governor on all applications for sales of debentures by the banks.

Staff and Service Divisions

In addition to the credit services which have the direct responsibility of supervising the activities of the banks and associations in the 12 districts, during the year ended June 30, 1963, there were several closely coordinated divisions. Two of these were staff divisions—legal and examination. Four were

service divisions—accounting and budget; finance; personnel; and research and information. * * *

FISCAL AGENT

18 John T. Knox, the fiscal agent for the Federal land banks, Federal intermediate credit banks, and banks for cooperatives, handles the sales of bonds and debentures for these banks. His office is located in the center of the financial district of New York City, at One Chase Manhattan Plaza. He arranges periodic sales of bonds and debentures for these banks to the public through a nationwide group of security dealers and dealer banks organized by his office. These sales provide the Farm Credit System's main source of lending funds.

He also buys and sells investment securities on request of the Farm Credit banks and associations.

In the year ended June 30, 1963, the fiscal agent's office, with a complement of five people, handled the sale of more than \$4.3 billion of securities. As in past years, intermediate credit bank debentures were sold monthly. There were four sales of Federal

land bank bonds and six sales of debentures of the banks
47 for cooperatives.

BANKS FOR COOPERATIVES

The greatly stepped up activities of farmers' marketing, purchasing, and business service cooperatives are reflected in the increased loan volume of the 13 banks for cooperatives. This has resulted in the banks setting new records both in the number of cooperatives served and in their volume of loan activity.

In financing farmers' cooperatives, the 13 banks are called upon to help many of them solve important problems. Typical of these problems are the narrow margins many cooperatives are having to operate on in an effort to meet extremely keen competition.

While the number of cooperatives continues to decline, mostly through mergers and consolidations, there has been a decided shift toward multiservice cooperatives. From these cooperatives members have a more complete and often one-stop service. In taking on more services, in addition to needing employees with the skills necessary to handle them, many cooperatives have to enlarge their facilities. The buildings and equipment needed often call for additional capital which is provided largely by borrowing.

Some cooperatives are changing from one type of service to another. A shift such as that from grain storage to grain merchandising not only may involve risk, but know-how and financing that are quite different from those related to the storage business.

In the farm supply field some cooperatives, as in the past, are encountering difficulties by extending open account credit to their member-patrons. Many of these cooperatives have taken steps to analyze their accounts receivable in order to develop a credit policy adapted to the best interest of both the cooperative and its entire membership. In several Farm Credit districts, cooperatives obtain some assistance with this problem by ar-

ranging with production credit associations to provide credit to the members of the cooperatives so they can pay for their purchases in cash.

New Loan Records Set

Farmers' marketing, purchasing, and business service cooperatives in borrowing \$946 million from the 13 banks for cooperatives in the year ended June 30, 1963, set a new record in their use of these banks. This amount was 10 percent more than in the previous year. New records were also made in number of borrowers with loans outstanding and in their outstanding balances. The 2,824 borrowing cooperatives with an estimated membership of 3.7 million, had loans outstanding amounting to \$701 million on June 30, 1963.

48 About 79 percent of the amount loaned was to marketing cooperatives, 18½ percent to farm supply cooperatives, and the remainder to farm business service and other cooperatives. By commodity groups, grain cooperatives accounted for 36 percent of the total amount loaned. While about 10 percent more grain cooperatives borrowed from the banks than during the previous year, the total amount they borrowed in the year was slightly less than in the previous year. The next largest group of borrowers—fruit and vegetable associations—borrowed 9 percent more money in the year.

Farm supply cooperatives borrowed about 22 percent more than in the previous year with borrowings of petroleum products associations up about 21 percent.

The amount borrowed by cooperatives providing farm business services was down about 6 percent from the previous year.

The amount of facility loans outstanding on June 30, 1963, totaled \$300 million, or about 9 percent more than a year earlier. Operating capital loans outstanding totaled \$346 million, or about 1 percent less than a year earlier. Commodity loans outstanding of \$55 million were down 21 percent from a year ago due mostly to repayments from grain and cotton which had moved out of storage earlier than in previous years.

Change in Maturity of Loans

The amount of short-term loans payable in 1 year outstanding on June 30, 1963, declined about 9 percent from a year earlier but the amount of long-term loans was up 15 percent. Of

the \$45 million increase in outstanding long-term loans \$43 million was in facility loans and \$2 million in operating capital loans.

Provide Credit on Sound Basis

The 12 district banks—1 in each Farm Credit district—and the Central Bank for Cooperatives in Washington, D.C., were organized under the Farm Credit Act of 1933. They provide a permanent source of credit for farmer cooperatives on a sound business basis. The Farm Credit Act of 1955 provides a plan under which the banks ultimately will be completely owned by farmers through their cooperatives. By June 30, 1963, Government capital had been reduced to about 30 percent of the banks' net worth. Cooperatives borrowing from the banks are engaged in processing, transporting, grading, packaging, and marketing of farm products; purchasing and manufacturing of farm supplies; and in furnishing farm business services.

Cooperatives borrow directly from the 12 district banks. The Central Bank for Cooperatives is largely engaged in assisting the district banks to serve their borrowers. Its main lending function is purchasing participations in larger loans made by the district banks, which exceed the lending limits of a district bank, and making direct loans to the 12 district banks to assist them in meeting their needs for lending funds.

Make Three Types of Loans

Three types of loans are available from banks for cooperatives. Commodity loans are used by cooperatives to help finance the storage and orderly marketing of agricultural products. Operating capital loans are used on a seasonal or longer term basis to supplement a cooperative's operating funds or working capital. Facility loans are used to construct or acquire physical facilities essential to operation and growth.

Working With Cooperatives

The banks for cooperatives continued during the year to make advice and counsel available especially to cooperatives facing adjustments in their operations. Many requests for assistance came from cooperatives considering mergers, consol-

idations, and other moves toward expansion. The banks were called upon to help a number of the cooperatives in improving their efficiency in order to meet especially keen competition. Many cooperatives needed counsel in regard to methods of acquiring the additional skills, facilities, and capital needed in making necessary adjustments.

The banks continued to help cooperatives in developing better financial planning, more effective membership relations, and director management and employee training programs. The banks have worked closely with borrowing cooperatives to help them in interpreting and complying with the provisions of the Revenue Act of 1962.

Continued effort was made to help borrowing cooperatives improve their audit reports. These reports are required at least yearly. The cooperatives also regularly send the banks operating reports, financial statements, budgets, and other operating, financial, and organization information. The banks also periodically review the business policies and operations of all borrowing cooperatives. The banks appraise the facilities when mortgage security is given.

In providing these and similar services, the banks not only helped cooperatives to improve their operations but enabled them to give better service to their farmer-members.

Meet Training and Research Needs

To meet the needs of the increased complexity of providing constructive credit for farmer cooperatives, at the request of the presidents of the banks for cooperatives, the Cooperative Bank Service of the Farm Credit Administration held three credit conferences. As in the previous year, four banks participated in each conference. At these conferences, actual loan cases were reviewed and studied. The practices, procedures, and policies used in the 13 banks were discussed and evaluated.

The 3-year study, "Trends in Financing Farmer Cooperatives," the most thorough and comprehensive study so far undertaken in the field of financing farmer cooperatives, continued in its second year. Principles, practices, and ideas regard-

ing the use of credit and equity capital helpful to farmer cooperatives are being developed in the study which is scheduled to be completed about June 30, 1964. The findings will be of help to the banks for cooperatives in improving their credit and counseling services.

Use Three Sources of Loan Funds

As in previous years, the banks for cooperatives loan funds came mainly from three sources—sales of debentures, short-term borrowings, and their net worth.

The average daily indebtedness of the banks to all sources of funds during the year was \$511 million compared with \$468 million the previous year. Peak month-end indebtedness was \$550 million on January 31, 1963, compared with \$510 million on March 31, 1962.

On June 30, 1963, the banks had borrowings of \$469 million outstanding compared with \$467 million a year earlier. This amount consisted of \$459 million of debentures compared with about \$430 million a year earlier; \$10 million in loans from commercial banks compared with \$36 million a year earlier; and notes payable to Farm Credit banks of \$350,000 compared with \$2 million a year earlier. Total borrowings from commercial banks and other Farm Credit banks during the year amounted to \$413 million compared with \$556 million the previous year.

More Debentures Sold

The banks for cooperatives continued a regular bimonthly schedule, begun 4 years ago, of selling debentures in the investment market. The six sales of short-term debentures total \$984 million compared with \$887 million in the previous year, up about 11 percent.

The interest paid on debentures varied from a low of 3.15 percent on \$160 million issued in December 1962 to a high of 3.48 percent on \$196 million sold in August 1962. The weighted average cost of debentures outstanding on June 30, 1963, was 3.27 percent, compared with 3.21 percent a year earlier, and 2.88 percent two years earlier. The weighted average cost to the banks of debentures issued during the year was 3.28 per-

cent compared with 3.18 a year earlier and 3.05 two years earlier.

The consolidated debentures issued by the banks for cooperatives are the joint and several obligations of the 13 banks for cooperatives. The U.S. Government assumes no liability, direct or indirect, for the debentures issued either as to payment of principal or interest. For further information on debentures see appendix table 42.

Intersystem Borrowing Continues

During the year, the banks borrowed \$108 million of temporarily surplus funds from Federal intermediate credit banks and \$48 million from Federal land banks, or a total of \$156 million. This compares with a total of \$212 million borrowed the previous year. Since the program began January 1, 1957, \$1.1 billion of temporarily surplus funds have been obtained by banks for cooperatives by intersystem borrowing.

On the other hand, the banks for cooperatives loaned \$89 million of their temporarily surplus funds to the land banks and intermediate credit banks during the year compared with \$41 million the previous year.

Cooperative Farm Credit System

TABLE 1.—*Loans and discounts made and outstanding*

	Loans and discounts made—				Loans and discounts outstanding June 30, 1963	
	Year ended June 30, 1963		From organization through June 30, 1963		Number	Amount
	Number	Amount	Number	Amount		
Banks and associations						
Federal land banks.....	46,657	4,82,113,560	1,777,602	\$9,957,929,184	380,493	\$3,198,005,630
Federal intermediate credit banks.....		4,405,959,574		50,137,327,446		2,292,711,616
Banks for cooperatives.....	2,209	945,995,709	43,193	12,162,578,518	12,824	700,562,049
Production credit associations.....		3,421,245,165		33,537,327,970	1,307,963	2,300,401,919
Grand total.....		9,455,505,338		105,825,463,118		8,491,681,214
Less Federal intermediate credit bank loans to and discounts for production credit associations and banks for cooperatives.....		4,131,697,345		43,351,361,366		2,166,014,213
Net total.....		5,323,807,993		62,474,101,752		6,325,666,901
Memo: Federal Farm Mortgage Corporation.....			679,900	1,218,018,739		

1 Number of cooperative associations having loans outstanding.

2 Number of members having loans outstanding.

Cooperative Farm Credit System

TABLE 2.—Interest and discount rates on specific dates

(Percent per annum)

Item	Dec. 31, 1933	June 30, 1934	June 30, 1935	June 30, 1936	June 30, 1937	June 30, 1938	June 30, 1939	June 30, 1940	June 30, 1941	June 30, 1942	June 30, 1943
Federal land banks: Federal land bank associations:											
Contract rate	5	4-1/2	4-1/2	4-5	4-5	4-5	5-3/4	6	5-5/8	5-5/8	5-5/8
Reduced rate 1	4-1/2										
Production credit associations	6	4-1/2	4-1/2	4-5	4-5	4-5	5-5/8	6-3/4	5-5/8	5-5/8	4-5/8
Federal intermediate credit banks	2 1/2-3	2	2-2/3	2-5/8	2-5/8	2-5/8	3-3/4	4-1/2	3-5/8	4-1/2	4-1/2
Blankets for cooperatives:											
Commodity loans		2 1/2	2 1/2-2 3/4	2 1/2-3	2 1/2-3 1/4	2 1/2-3 1/4	3 1/2-4 1/2	4-5	4-5	4-5	4-5
Operating capital loans	4	3	3	3-3/4	3-3/4	3-3/4	4-5	5-6	4-5/8	4-5/8	4-5/8
Facility loans	4 1/2	4	4	4-1/2	4-1/2	4-1/2	5-6	5-6	4-5/8	4-5/8	4-5/8

1 Interest charged borrowers on Federal land bank loans from July 11, 1933, to June 30, 1944, was at reduced rates authorized by Congress.

Cooperative Farm Credit System

TABLE 3.—Net worth

Banks and associations	June 30, 1963					June 30, 1963			Peak capital owned by U.S. Government	
	Member-owned capital	U.S. Government capital	Earned net worth	Total net worth	Member-owned capital	U.S. Government capital	Earned net worth	Total net worth	Amount	Date
Federal land banks.....	\$189,644,570	.....	\$318,371,644	\$508,016,214	\$173,617,230	.....	\$228,150,510	\$473,767,740	\$313,942,505	June 30, 1960
Federal land bank associations.....	189,688,253	.....	102,770,833	292,459,118	173,697,590	.....	94,926,356	270,623,986	.....	.....
Federal intermediate credit banks.....	149,891,175	\$114,889,120	79,101,512	213,991,507	140,324,790	\$101,359,120	75,067,029	216,680,939	114,989,120	June 30, 1963
Production credit associations.....	225,116,913	175,000	107,531,612	392,133,525	297,341,149	495,000	153,435,773	336,284,922	90,106,775	Nov. 30, 1964
Banks for cooperatives.....	80,111,973	80,911,100	107,732,113	\$68,775,196	66,899,229	94,837,500	106,623,708	267,480,467	178,500,000	May 1945 to Feb. 28, 1964
Grand total.....	734,452,916	165,075,220	767,527,714	1,626,653,850	661,163,668	196,691,620	727,253,426	1,553,138,054	XXX	.....
Less intercorporate items.....	237,219,765	.....	.....	237,219,765	214,302,875	.....	.....	214,302,875	XXX	.....
Net total.....	497,233,151	165,075,220	767,527,711	1,409,434,085	446,860,793	196,691,620	727,253,426	1,370,785,179	638,392,995	June 30, 1960

* Includes \$2,315,980 in 1963 and \$1,789,435 in 1962 in participation certificates owned by financing institutions other than production credit associations.

Farm Mortgage Loans Made or Recorded

TABLE 4.—Farm mortgage loans made and estimated amount of farm mortgages recorded by principal lenders during the year ended June 30, 1963, by Farm Credit districts¹

(Thousands)

District	Loans made by Federal land banks ²	Mortgages recorded ³				Total all lenders
		Individuals	Banks and trust companies	Insurance companies	Miscellaneous lenders ⁴	
Springfield.....	\$10,000	\$22,313	\$42,731	\$1,054	\$20,205	\$106,269
Baltimore.....	18,544	40,582	91,782	10,324	31,162	192,374
Columbia.....	58,017	55,870	78,043	24,872	184,657	381,459
Covington.....	74,053	48,650	132,511	60,404	177,811	493,428
New Orleans.....	44,381	34,534	50,961	31,648	82,913	244,437
St. Louis.....	62,274	61,640	84,538	113,296	87,840	409,788
St. Paul.....	103,700	36,459	100,220	42,403	49,430	334,221
Omaha.....	8,073	70,289	38,783	103,805	49,155	347,105
Wichita.....	53,019	73,454	40,248	83,230	41,531	291,473
Houston.....	19,862	96,276	41,787	92,744	55,516	346,185
Berkeley.....	61,399	159,709	98,734	50,410	93,989	464,241
Spokane.....	53,571	25,622	22,945	47,846	57,422	207,406
United States.....	694,950	725,507	823,263	603,026	911,640	3,818,386

¹ 48 States only.² Includes outstanding balances as well as new money advanced where existing borrowers obtained additional loans.³ Estimates based on reports from counties including approximately 60 percent of the farms in the United States.⁴ Includes the Farmers Home Administration; mortgage and investment companies; savings and loan associations; when the mortgage appears to cover farm real estate; State and local governmental agencies; agents and representatives of undisclosed lenders; production credit associations, when the mortgage is secured by farm real estate; religious, educational, civic, and fraternal organizations; and any other lenders not specifically mentioned.

Farm Mortgage Loans Made or Recorded

TABLE 5. Estimated total amount of farm mortgages recorded by all lenders, by Farm Credit districts: 1939

Year ended	Spring field	Full year	Columbia	Conestoga	New Orleans	St. Louis	St. Paul	Omaha	Wichita	Hankook	Spokane	United States
Dec. 31												
1910	\$11.0	\$11.3	\$11.0	\$11.0	\$11.3	\$11.7	\$11.0	\$11.0	\$11.3	\$11.3	\$11.3	\$11.3
1911	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1912	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1913	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1914	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1915	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1916	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1917	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1918	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1919	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1920	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1921	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1922	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1923	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1924	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1925	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1926	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1927	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1928	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1929	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1930	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1931	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1932	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1933	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1934	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1935	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1936	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1937	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1938	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1939	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1940	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1941	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1942	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1943	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1944	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1945	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1946	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1947	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1948	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1949	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1950	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1951	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1952	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1953	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1954	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1955	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1956	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1957	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1958	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1959	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1960	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1961	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1962	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1963	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1964	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1965	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1966	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1967	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1968	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1969	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1970	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1971	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1972	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1973	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1974	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1975	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1976	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1977	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1978	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1979	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1980	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1981	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1982	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1983	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1984	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1985	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1986	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1987	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1988	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1989	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1990	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1991	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1992	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1993	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1994	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1995	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1996	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1997	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1998	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
1999	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2000	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2001	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2002	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2003	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2004	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2005	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2006	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2007	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2008	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2009	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11.3
2010	11.0	11.3	11.0	11.0	11.3	11.7	11.0	11.0	11.3	11.3	11.3	11

¹ Estimates for the years 1910 through 1953 were prepared by the Economic Research Service (formerly the Bureau of Agricultural Economics) U.S. Department of Agriculture. From 1954 to 1955 estimates were prepared by the Farm Credit Administration. Estimates for 1954 and 1955 were prepared jointly. Since 1955, estimates have been prepared by the Federal land banks.

* MS System only

Banks for Cooperatives

TABLE 36.—*Loans made and repayments for the year ended June 30, 1963, and loans outstanding, June 30, 1963*

Bank	Loans made	Repayments	Loans outstanding
Springfield.....	\$36,305,574	\$34,763,035	\$21,504,491
Baltimore.....	49,593,912	47,584,066	40,882,192
Columbia.....	70,692,664	57,950,571	56,174,037
Louisville.....	56,370,242	54,883,032	23,637,036
New Orleans.....	47,133,120	36,779,354	27,939,959
St. Louis.....	171,286,664	167,481,232	99,625,679
St. Paul.....	152,141,979	170,687,679	99,296,708
Omaha.....	72,701,444	76,602,866	52,228,450
Wichita.....	79,517,723	94,631,500	90,683,350
Houston.....	75,948,654	73,853,897	41,957,836
Berkeley.....	94,537,424	88,223,428	91,519,958
Spokane.....	36,745,249	32,228,091	36,092,353
Eliminations: Participation loans.....	600,000	600,000	
Total.....	943,253,409	934,301,355	699,002,049
Central Bank.....	310,288,525	339,037,928	123,012,225
Eliminations: Participation loans.....	308,609,225	327,787,196	121,452,225
Grand total.....	945,542,709	936,547,087	700,562,049

TABLE 37.—*Loans outstanding, June 30, 1963; by type of loan*

Bank	Commodity		Operating capital		Facility		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Springfield.....			79	\$10,945,647	44	\$4,618,811	94	\$21,504,491
Baltimore.....	3	\$2,397,687	68	26,739,065	40	14,745,500	76	40,882,192
Columbia.....	6	9,121,632	48	21,574,029	44	22,477,776	58	56,174,037
Louisville.....	1	152,000	296	29,213,830	250	21,241,296	299	53,637,036
New Orleans.....	1	1,000,000	68	9,701,508	112	17,238,421	189	27,939,959
St. Louis.....	9	19,819,264	179	29,673,514	190	47,137,591	233	99,625,679
St. Paul.....	1	790	387	65,059,247	213	21,626,658	601	99,296,708
Omaha.....	13	4,321,682	339	30,768,319	278	17,139,019	385	52,228,450
Wichita.....	18	5,635,755	302	32,611,514	451	51,785,281	496	90,683,350
Houston.....	2	1,927,677	84	12,389,297	195	27,640,952	205	41,957,836
Berkeley.....	7	8,512,785	95	45,587,322	199	37,116,851	137	91,519,958
Spokane.....			50	21,724,373	83	14,367,980	95	36,092,353
Eliminations: Participation loans.....								
Total.....	61	53,233,675	1,965	345,598,373	2,079	300,169,999	2,823	699,002,049
Central Bank.....	8	6,684,500	30	91,707,928	15	24,619,797	41	123,012,225
Eliminations: Participation loans.....	7	5,124,500	30	91,707,928	15	24,619,797	40	121,452,225
Grand total.....	62	54,793,675	1,965	345,598,375	2,079	300,169,999	2,824	700,562,049

¹ Represents number of cooperative associations having loans outstanding.

² Associations having more than one type of loan are counted only once in the total column.

Banks for Cooperatives

TABLE 38.—*Loans outstanding, June 30, 1963, by type, and by principal product or service*

Principal product or service	Commodity		Operating capital		Facility		Total	
	Number ¹	Amount	Number ¹	Amount	Number ¹	Amount	Number ¹	Amount
Farm products								
Citrus fruits.....	3	\$7,363,632	13	\$3,385,050	15	\$5,431,580	22	\$16,181,177
Other fruits and vegetables.....	3	812,193	84	80,419,492	87	20,228,479	115	77,460,161
Wine and brandy.....	6	8,812,785	12	4,115,056	6	1,278,085	13	11,205,926
Dairy.....	1	2,000,000	158	30,728,165	152	28,037,925	228	60,833,090
Poultry.....	2	802,700	24	8,746,947	21	5,187,348	29	14,436,995
Grain.....	30	25,352,934	600	86,850,548	800	88,490,660	1,040	200,729,838
Tobacco.....			5	4,606,281	9	443,450	11	5,109,701
Sugar.....	2	1,882,618	2	1,209,361	12	14,217,923	13	17,309,902
Wool and mohair.....	2	1,942,575	3	2,325,100	1	57,000	5	4,324,675
Cotton fiber.....	5	4,765,677	4	4,789,745	8	3,181,495	9	12,696,827
Livestock.....			13	1,518,282	10	655,000	15	2,173,372
Products of oil-bearing crops.....	5	1,409,563	17	9,958,224	16	8,567,180	22	20,021,967
Peanuts.....			1	821,511				821,511
Seed.....			6	1,323,691	5	509,844	8	1,833,705
Other.....	1	202,745	11	6,174,799	10	5,296,538	15	11,643,882
Total farm products	63	72,177,442	1,037	216,716,871	1,218	187,776,016	1,345	476,510,379
Farm supply								
General.....	1	1,940,000	441	84,391,879	289	44,672,185	444	131,304,064
Petroleum products.....			301	31,366,127	106	4,647,354	329	36,319,481
Other.....			12	3,488,577	19	23,683,134	22	27,171,711
Total farm supply	1	1,940,000	754	119,246,583	414	73,002,673	496	194,709,256
Farm business services								
Irrigation.....			13	261,611	72	3,328,087	77	3,589,697
Insurance.....			1	4,000			1	4,000
Warehousing.....			5	149,500	70	3,131,550	11	3,281,059
Cotton gins.....			92	3,106,461	272	20,331,113	276	23,437,574
Refrigerated food lockers.....					3	10,570	3	10,570
Grain drying.....			7	480,700	27	6,403,618	27	6,884,318
Other.....			10	1,244,690	10	351,038	14	1,595,748
Total farm business services			128	5,246,962	394	33,556,004	409	38,802,966
Miscellaneous								
Farmers' exchanges.....	1	676,233	22	4,245,109	22	3,130,206	29	8,051,548
Other.....			4	102,850	1	2,325,100	5	2,427,950
Total miscellaneous	1	676,233	26	4,347,959	23	5,455,306	34	10,479,498
Grand total	62	54,793,675	1,965	345,598,375	2,079	300,169,999	2,824	700,562,049

¹ Figures are for cooperative associations having loans outstanding.² An association having more than one type of loan or more than one type of product or service is counted only once in total column.

Banks for Cooperatives

TABLE 39.—Credit extended during specified periods

Bank	Organization through June 30, 1933 ¹	Year ended June 30—					Organization through June 30, 1933
		1930	1931	1932	1933		
Springfield.....	\$440,838.051	\$21,810.689	\$21,008.350	\$22,928.164	\$39,395.574	\$506,352.653	
Baltimore.....	381,857.961	40,136.991	38,049.579	47,287.693	43,593.912	572,491.749	
Columbia.....	570,384.729	35,432.721	47,193.637	49,399.711	70,691.664	834,973.773	
Louisville.....	492,036.233	35,610.796	39,562.669	53,732.964	56,379.242	722,133.759	
New Orleans.....	470,765.823	23,087.584	23,099.569	29,690.729	45,133.150	618,328.623	
St. Louis.....	773,344.207	61,431.328	106,342.591	138,342.881	171,286.464	1,072,354.794	
St. Paul.....	827,176.708	100,630.792	106,393.111	165,239.563	133,153.629	1,479,277.199	
Omaha.....	328,489.961	36,993.244	38,923.317	64,438.527	72,791.444	616,349.839	
Wichita.....	680,088.740	79,117.392	55,842.259	103,235.059	79,317.723	1,074,962.673	
Houston.....	537,967.098	43,002.854	62,066.891	59,794.021	73,946.654	740,791.611	
Berkeley.....	828,830.859	77,624.981	82,516.468	82,433.068	94,537.674	1,297,243.969	
Spokane.....	325,304.973	28,666.439	27,740.769	29,331.729	26,743.269	417,341.943	
Eliminations: Participation loans.....	26,638.033	500.000	600.000	600.000	600.000	29,138.033	
Total.....	6,640,459.643	614,046.131	662,159.824	857,549.615	943,253.679	10,461,312.913	
Central Bank.....	3,854,954.751	193,019.122	204,468.303	290,441.028	310,289.225	4,858,696.553	
Eliminations: Participation loans.....	1,608,003.981	171,298.812	194,131.545	292,633.623	304,003.225	2,658,396.773	
Total.....	8,667,465.413	636,728.431	672,464.754	640,327.631	943,306.799	12,519,711.786	

¹ Includes advances under Commodity Credit Corporation programs.

Banks for Cooperatives

TABLE 40.—*Loans made during the year ended June 30, 1963, and loans outstanding, June 30, 1963*

District and State	Loans made		Loans outstanding	
	Number	Amount	Number ¹	Amount
District 1:				
Maine.....	13	\$7,794,145	6	\$1,318,593
New Hampshire.....	1	236,876	1	220,834
Vermont.....	3	347,309	4	309,412
Massachusetts.....	5	15,663,300	7	9,462,825
Rhode Island.....				
Connecticut.....	5	1,800,400	4	1,376,050
New York.....	30	12,627,692	69	10,245,204
New Jersey.....	3	89,152	4	221,873
Total.....	60	38,558,874	95	23,154,491
District 2:				
Pennsylvania.....	50	16,950,192	42	13,622,262
Delaware.....				
Maryland.....	5	1,624,000	4	987,907
Virginia.....	18	11,294,250	20	15,469,742
West Virginia.....	4	70,080	3	67,436
Puerto Rico.....	11	20,575,390	7	10,714,845
Total.....	68	49,533,912	76	40,882,192
District 3:				
North Carolina.....	16	2,686,381	13	5,969,839
South Carolina.....	18	1,181,584	11	1,215,972
Georgia.....	14	24,959,487	12	19,947,252
Florida.....	44	41,782,412	22	29,616,974
Total.....	92	70,609,864	58	56,174,637
District 4:				
Ohio.....	33	20,451,069	154	20,450,966
Indiana.....	49	17,931,045	92	21,950,425
Kentucky.....	5	4,800,000	7	968,250
Tennessee.....	68	13,188,188	66	10,267,395
Total.....	155	56,370,242	229	53,637,036
District 5:				
Alabama.....	24	3,249,650	22	3,447,058
Mississippi.....	64	30,620,955	90	21,078,635
Louisiana.....	27	11,262,515	27	3,414,260
Total.....	115	45,133,120	139	27,939,953
District 6:				
Illinois.....	145	46,477,613	131	36,763,063
Missouri.....	46	35,798,701	54	30,093,191
Arkansas.....	27	89,010,150	49	29,996,138
Total.....	218	171,286,464	234	96,852,392

Banks for Cooperatives

TABLE 40.—*Loans made during the year ended June 30, 1963, and loans outstanding, June 30, 1963—Continued*

District and State	Loans made		Loans outstanding	
	Number	Amount	Number ¹	Amount
District 7:				
Michigan.....	52	\$23,296,810	80	\$10,912,837
Wisconsin.....	108	18,083,766	145	10,760,275
Minnesota.....	153	109,312,250	254	65,446,935
North Dakota.....	54	2,231,373	153	2,459,949
Total.....	367	152,923,939	602	90,079,956
District 8:				
Iowa.....	308	51,525,478	364	38,470,338
South Dakota.....	24	2,088,465	30	2,658,468
Nebraska.....	108	18,661,003	89	10,799,119
Wyoming.....	1	236,498	5	300,527
Total.....	441	72,501,444	388	52,228,450
District 9:				
Kansas.....	177	44,907,488	238	57,569,593
Oklahoma.....	80	26,550,043	142	21,056,445
Colorado.....	29	7,588,662	95	8,789,295
New Mexico.....	6	471,500	21	2,668,017
Total.....	292	79,517,723	496	90,083,350
District 10:				
Texas.....	190	75,948,654	205	41,957,836
District 11:				
Arizona.....	14	1,985,420	10	3,098,815
Utah.....	7	6,173,500	6	3,111,452
Nevada.....	1	—	—	—
California.....	102	86,178,594	121	85,309,691
Total.....	124	94,337,424	137	91,519,658
District 12:				
Montana.....	5	200,700	13	716,069
Idaho.....	14	3,002,431	14	5,895,613
Washington.....	40	11,637,638	42	10,435,095
Oregon.....	26	23,904,480	26	19,045,556
Total.....	85	38,745,249	95	36,092,353
Grand total.....	2,209	945,506,709	2,824	700,562,049

¹ Represents cooperative associations having loans outstanding.

Banks for Cooperatives

TABLE 41.—*Loans made and outstanding*

Year ended June 30—	Loans made		Loans outstanding at end of period	
	Number	Amount	Number of cooperatives having loans outstanding	Amount
1934.....	(1)	\$36,753,583	(1)	\$20,539,458
1935.....	(1)	50,785,251	979	23,936,683
1936.....	12,527	63,679,134	1,209	39,500,033
1937.....	1,246	85,543,877	1,465	45,032,454
1938.....	1,320	109,884,695	1,614	81,190,495
1939.....	1,145	86,161,001	1,645	59,576,528
1940.....	1,290	90,117,448	1,689	62,176,619
1941.....	1,459	130,900,052	1,728	73,746,996
1942.....	1,625	200,943,417	1,732	101,225,869
1943.....	1,115	267,289,848	1,476	101,885,250
1944.....	1,127	416,168,106	1,328	143,013,678
1945.....	1,050	379,885,224	1,247	134,859,835
1946.....	1,023	341,899,498	1,251	114,549,781
1947.....	1,271	427,482,904	1,379	155,238,680
1948.....	1,303	547,528,483	1,559	231,518,249
1949.....	1,164	458,716,117	1,666	248,008,208
1950.....	1,318	372,659,298	1,754	244,605,580
1951.....	1,607	509,553,818	1,920	311,280,234
1952.....	1,417	536,879,618	1,925	342,377,354
1953.....	1,385	568,562,554	2,024	319,108,543
1954.....	1,377	491,173,531	2,050	\$33,565,019
1955.....	1,425	560,034,236	2,129	316,794,806
1956.....	1,633	567,220,422	2,277	349,074,140
1957.....	1,780	583,577,726	2,393	384,328,803
1958.....	1,921	630,122,357	2,523	408,257,152
1959.....	2,378	639,728,451	2,689	525,880,724
1960.....	2,030	672,464,784	2,754	550,712,891
1961.....	1,988	757,349,328	2,795	594,548,829
1962.....	2,057	860,337,051	2,817	692,362,803
1963.....	2,209	945,506,709	2,824	700,562,049
Total.....	43,193	12,162,878,518		

1 Not available.

2 Organization 1933 to date.

Banks for Cooperatives

TABLE 42.—Consolidated debentures issued, retired, and outstanding, year ended June 30, 1963

Description of issue		Unmatured debentures outstanding June 30, 1962	Debentures issued dur- ing year	Debentures retired dur- ing year	Unmatured debentures outstanding June 30, 1963
Rate and maturity	Date of issue				
4.20% Aug. 1, 1962.....	Feb. 1, 1962	\$141,000,000	-----	\$141,000,000	-----
3.10% Oct. 1, 1962.....	Apr. 2, 1962	156,500,000	-----	156,500,000	-----
3.05% Dec. 3, 1962.....	June 4, 1962	132,000,000	\$3,500,000	135,500,000	-----
3 3/8% Feb. 4, 1963.....	Aug. 1, 1962	-----	198,000,000	198,000,000	-----
3.15% Apr. 1, 1963.....	Oct. 1, 1962	-----	161,000,000	161,000,000	-----
3.05% June 3, 1963.....	Dec. 3, 1962	-----	162,500,000	162,500,000	-----
3.15% Aug. 1, 1963.....	Feb. 4, 1963	-----	169,000,000	-----	\$169,000,000
3.15% Oct. 1, 1963.....	Apr. 1, 1963	-----	160,000,000	-----	160,000,000
3.20% Dec. 2, 1963.....	June 3, 1963	-----	133,000,000	-----	133,000,000
Total.....	-----	429,500,000	967,000,000	954,500,000	462,000,000

¹ Included \$3,000,000 debentures issued for use as collateral for short-term borrowings and not a part of the public issue.

Banks for Cooperatives

TABLE 43.—Combined statements of condition

ASSETS	June 30, 1963	June 30, 1962
Loans to cooperative associations:		
Commodity.....	\$54,793,675	\$60,264,954
Operating capital.....	345,598,375	348,604,708
Facility.....	300,160,999	274,433,141
Total.....	700,562,049	682,362,803
Less participation certificates out- standing.....	13,061	18,367
Net.....	\$700,548,988	\$692,344,436
Notes receivable and sales contracts.....	505,908	451,698
Accrued interest receivable on loans, notes receivable, and sales con- tracts.....	8,263,713	7,930,222
Total.....	709,318,609	700,726,356
Less reserve for losses.....	8,255,794	6,650,189
Net.....	701,062,815	694,076,167
Loans to other Farm Credit banks.....	750,000	1,900,000
Cash.....	12,094,571	12,258,554
U.S. Government securities (par).....	43,051,000	43,000,000
Unamortized premium (or discount) (net).....	(269,539)	20,733
Loans in process of liquidation.....	340,221	51,440
Less reserve.....	51,000	310,221
Assets acquired in liquidation of banks.....	207,324	228,437
Less reserve.....	143,992	64,332
Fixed and other assets.....	2,575,701	2,492,433
Less provision for depreciation.....	511,614	476,921
Total assets.....	709,130,547	753,438,300

Banks for Cooperatives

TABLE 43.—Combined statements of condition—Continued

LIABILITIES	June 30, 1963		June 30, 1962	
Unmatured consolidated debentures outstanding.....	\$472,000,000		\$429,500,000	
Less debentures owned.....	3,000,000	\$429,000,000		\$429,500,000
Notes payable:				
Commercial banks.....	10,073,000		33,615,000	
Other Farm Credit banks.....	350,000	10,423,000	2,000,000	37,615,000
Accrued interest payable.....		3,782,094		3,443,317
Dividends payable on class B capital stock and guaranty fund.....		372,936		405,641
Federal franchise tax payable.....		2,170,263		2,250,367
Due U.S. Government—Retirement of class A capital stock.....		13,926,400		11,979,500
Other liabilities.....		674,648		763,968
Capital stock and guaranty fund:				
Class A—U.S. Government.....	94,837,500		106,817,000	
Less in process of retirement.....	13,926,400		11,979,500	
Net.....	80,911,100		94,837,500	
Class B—Cooperative associations and others.....	11,229,369		12,235,983	
Class C—Cooperative associations.....	68,830,284		84,663,778	
Other—Cooperative associations.....	51,300		89,400	
Total.....	161,023,073		161,826,750	
Surplus—Reserved.....	88,111,198		88,111,198	
Surplus—Allocated to patrons.....	19,640,915	268,775,186	17,542,510	267,450,467
Total liabilities.....		759,126,847		753,438,800

NOTES

(a) Loans of \$196,053,426 in 1963, and \$452,379,234 in 1962 were assigned as collateral for consolidated debentures, which are issued by and are the liability of the 13 banks for cooperatives.

(b) Loans of \$9,080,000, U.S. Government securities of \$4,448,000 (par amount) in 1963, and loans of \$48,617,134 and U.S. Government securities of \$4,439,000 (par amount) in 1962 were assigned as collateral for notes payable.

(c) This statement does not include outstanding letters of credit issued by banks in the sums of \$97,000 during 1963, and \$485,000 during 1962. Advances made under these letters of credit will be recorded as loans to cooperative associations.

(d) This statement does not include a liability of \$162,244, in 1962 for matured debentures (principal and interest), or a like amount of cash deposited with the Treasurer of the United States for their payment.

(e) The liability to the U.S. Government of \$13,926,400 on June 30, 1963, and \$11,979,500 on June 30, 1962, are the amounts of class A stock which the banks determine to retire in accordance with section 42 of the Farm Credit Act of 1933, as amended. Actual retirement was made shortly after the end of the fiscal years.

Banks for Cooperatives

TABLE 44.—Statements of condition, June 30, 1963

ASSETS	Central Bank	Springfield	Baltimore	Columbia	Louisville	New-Orleans
Loans to cooperative associations:						
Commodity.....	\$6,684,600		\$2,397,687	\$9,121,632	\$452,000	\$1,000,000
Operating capital.....	91,707,928	\$10,945,947	26,739,005	24,574,820	29,243,830	9,701,538
Facility.....	26,619,797	4,648,844	11,745,500	22,477,776	24,241,206	17,293,421
Total.....	123,012,225	21,594,491	40,882,192	56,174,037	53,637,036	27,995,959
Less participation certificates outstanding.....		3,038,000	10,227,000	23,262,667	2,374,500	7,170,320
Net.....	123,012,225	18,556,491	30,655,192	32,911,040	51,262,536	20,769,639
Notes receivable and sales contracts.....			27,500	6,937		177,543
Accrued interest receivable on loans, notes receivable, and sales contracts.....	1,618,627	253,762	146,868	455,431	576,096	346,973
Total.....	124,630,852	18,810,253	30,802,060	33,366,478	51,838,632	21,294,155
Less reserve for losses.....	1,804,748	310,147	658,124	362,000	245,000	312,270
Net.....	122,826,104	18,499,106	30,143,936	33,004,478	51,593,632	20,981,885
Loans to other Farm Credit banks.....	39,496,600					
Cash.....	2,714,123	1,284,332	301,660	1,325,900	859,810	610,994
U.S. Government securities (par).....	15,212,000	1,632,000	1,757,000	2,338,000	2,371,000	2,595,000
Unamortized premium (or discount) (net).....	(154,069)	(30,431)	15,418	30,943	30,724	(21,056)
Total.....	16,057,911	1,601,569	1,772,418	2,468,943	2,401,724	2,573,944
Investment in Central Bank for Cooperatives.....		1,114,754	1,892,120	2,292,433	1,378,562	644,802
Dividends receivable on class B capital stock—Central Bank.....		1,500		6,000	3,000	1,500
Loans in process of liquidation.....			5,970	279,442	42,546	
Less reserve.....				50,000		
Net.....			5,970	229,442	42,546	
Assets acquired in liquidation of loans:						
Less reserve.....		78,643	62,150			3,359
Net.....		78,643	15,000			3,359

Fixed and other assets.....	631,297	134,874	110,000	237,854	211,450	134,098
Less provision for depreciation.....	25,178	5,410	34,147	30,047	35,187	29,010
Net.....	606,119	129,464	75,853	207,807	176,263	105,088
Total assets.....	181,721,117	99,600,745	34,373,743	30,408,413	55,033,546	24,079,072
LIABILITIES						
Unmatured consolidated debentures outstanding.....						
Less debentures owned.....						
Net.....	90,000,000	6,000,000	15,000,000	31,500,000	30,500,000	10,500,000
Notes payable.....	90,000,000	6,000,000	15,000,000	31,500,000	30,500,000	10,500,000
Commercial banks.....		900,000			1,000,000	
Other Farm Credit banks.....		1,500,000	2,625,000	1,525,000	2,025,000	1,400,000
Total.....	2,000,000	2,525,000	1,525,000	1,525,000	2,025,000	1,400,000
Accrued interest payable.....	608,785	60,882	137,739	206,319	283,991	54,645
Dividends payable on class B capital stock and guaranty fund.....	64,137	24,351	27,749	37,156	2,824	11,977
Federal franchise tax payable.....	698,118	93,186	108,723	131,173	121,264	43,754
Due U.S. Government—Retirement of class A capital stock.....	3,000,000	441,000	525,000	560,000	1,100,000	2,000,000
Other liabilities.....	127,415	142,577	54,692	103,190	16,426	104,796
Capital stock and guaranty fund:						
Class A—U.S. Government.....	36,900,000	4,807,400	6,314,100	4,500,000	4,000,000	5,270,000
Less in process of retirement.....	3,000,000	441,000	525,000	560,000	1,100,000	2,000,000
Net.....	33,900,000	4,366,400	5,789,100	4,000,000	2,900,000	4,880,000
Class B—Cooperative associations and others.....	2,137,000	812,692	634,953	928,970	900,400	399,562
Class C—District banks.....	16,861,453	3,065,797	4,517,353	3,008,568	5,632,013	2,651,348
Other—Cooperative associations.....		1,500	2,100	9,000	800	
Total.....	52,900,453	8,246,799	11,234,543	9,947,870	8,590,803	3,961,110
Surplus—Reserved.....	20,675,993	4,418,527	2,575,713	3,370,967	5,190,412	3,657,554
Surplus—Allocated to patrons.....	4,889,366	832,803	1,182,419	1,176,830	1,192,529	711,449
Total capital and surplus.....	87,164,702	13,517,719	14,992,739	13,488,173	14,964,041	12,380,447
Total liabilities.....	181,721,117	22,680,763	34,373,743	30,408,413	55,033,546	24,079,072

Banks for Cooperatives

TABLE 44.—Statements of condition, June 30, 1963—Continued

ASSETS	St. Louis	St. Paul	Omaha	Wichita	Houston	Berkley	Spokane
Loans to cooperative associations:							
Commodity.....	\$19,811,561	\$7,911	\$1,321,082	\$5,085,776	\$1,927,077	\$8,812,785	9
Operating capital.....	29,675,911	65,636,212	20,768,319	22,611,214	12,396,207	65,587,222	\$21,734,478
Facility.....	47,137,501	21,628,658	17,136,019	57,786,581	27,648,932	37,116,831	14,867,950
Total.....	96,625,079	90,296,789	32,225,420	90,583,850	41,957,836	91,516,838	36,092,353
Long participation certificates outstanding.....	14,018,040	42,325,061	2,215,000	16,443,000	4,108,000	11,023,803	348,000
Net.....	82,607,039	47,971,728	30,010,420	74,140,850	37,849,836	79,897,135	35,743,353
Notes receivable and sales contracts.....		6,560		31,209			330,819
Accrued interest receivable on loans, notes receivable, and sales contracts.....	877,511	707,787	998,431	667,767	830,147	750,433	422,515
Total.....	83,484,550	48,685,754	30,911,871	80,542,410	38,687,983	80,647,568	36,418,683
Less reserve for loans.....	1,018,301	930,070	438,174	534,907	527,503	723,821	385,000
Net.....	82,466,249	47,755,684	30,473,697	80,007,503	37,800,382	79,916,746	36,034,683
Loans to other Farm Credit banks.....							
Cash.....	977,000	332,021	182,740	1,058,491	242,835	1,028,107	534,632
U.S. Government securities (par).....	2,077,049	2,494,000	1,528,000	2,887,000	2,421,009	2,070,000	2,546,000
Unamortized premium (or discount) (net).....	(12,741)	(18,562)	10,220	(29,210)	6,166	(30,638)	(32,117)
Total.....	2,064,277	2,475,439	1,548,260	2,866,080	2,423,166	2,075,469	2,513,882
Investments in Central Bank for Cooperatives.....	2,805,752	4,253,668	499,169	1,621,341	733,179	2,432,277	328,556
Dividends receivable on class B capital stock—Central Bank.....	12,700	12,801	1,300	10,500	1,800	6,600	1,800
Loans in progress of liquidation.....							30,293
Less reserve.....							
Net.....							32,563
Assets acquired in liquidation of loans.....				50,931		11,275	909
Less reserve.....				45,000		8,349	
Net.....				5,931	1	2,926	909

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Fitted and other assets.....	312,052	201,000	108,118	203,178	186,026	327,480	120,118
Less provision for depreciation.....	45,917	62,202	34,452	70,315	86,717	62,121	21,871
Net.....	266,135	138,798	73,666	132,863	99,309	265,359	98,247
Total assets.....	88,311,517	66,178,991	82,979,040	83,776,519	61,534,181	99,776,786	39,545,021
LIABILITIES							
Unmatured consolidated debentures outstanding.....	50,000,000	73,000,000	25,000,000	57,000,000	21,000,000	54,000,000	22,000,000
Less debentures owned.....				27,000,000			
Net.....	50,000,000	73,000,000	25,000,000	30,000,000	21,000,000	54,000,000	22,000,000
Notes payable.....							
Commercial banks.....	2,121,000		3,300,000	1,000,000	2,300,000	2,200,000	
Other Farm Credit banks.....	4,735,000	5,025,000	3,300,000	5,017,000	1,825,000	5,900,000	3,150,000
Total.....	6,856,000	5,025,000	6,600,000	6,017,000	4,025,000	8,100,000	3,150,000
Accrued interest payable.....	471,120	364,837	306,451	481,421	300,113	483,756	144,214
Dividends payable on class B capital stock and guaranty fund.....	32,830	66,132	22,333	20,916	20,243	36,298	4,500
Federal franchise tax payable.....	175,615	183,215	171,362	172,140	171,295	128,703	115,474
Due U.S. Government—Retirement of class A capital stock.....	1,628,000	1,215,000	719,000	1,100,000	1,000,000	1,000,000	620,430
Other liabilities.....	81,115	125,585	69,422	25,791	30,562	55,007	26,375
Capital stock and guaranty fund.....							
Class A—U.S. Government.....	3,900,000	8,440,000	4,000,000	4,015,000	4,000,000	4,300,000	4,300,000
Less in process of retirement.....	1,630,000	1,215,000	719,000	1,100,000	1,000,000	1,000,000	620,430
Net.....	2,270,000	7,225,000	3,281,000	2,915,000	3,000,000	3,300,000	3,679,570
Class B—Cooperative associations and others.....	1,800,000	1,388,770	743,100	2,379,400	841,500	780,756	95,622
Class C—District banks.....							
Class O—Cooperative associations.....	8,438,815	10,300,000	4,002,101	6,858,435	4,987,362	8,318,362	3,566,185
Other—Cooperative associations.....		4,100	15,100	1,000	200	10,000	8,400
Total.....	14,002,514	17,944,780	8,195,301	12,123,035	8,828,562	12,469,318	7,437,877
Surplus—Reserved.....	6,138,812	6,684,355	2,423,117	6,715,508	8,038,038	6,658,127	3,014,148
Surplus—Allocated to patrons.....	2,723,148	2,437,393	917,598	1,813,704	1,231,312	2,346,030	957,162
Total capital and surplus.....	22,864,474	26,106,528	11,536,006	20,652,247	18,115,912	21,464,465	13,439,142
Total liabilities.....	88,311,517	66,178,991	82,979,040	83,776,519	61,534,181	99,776,786	39,545,021

See notes table 42.

Banks for Cooperatives

TABLE 45.—Statements of earnings and earned surplus for the year ended June 30, 1963

Item	Central Bank	Springfield	Baltimore	Columbia	Louisville	New Orleans
Earnings:						
Interest on loans to cooperative associations	\$7,051,725	\$918,348	\$1,420,933	\$1,527,803	\$5,315,219	\$1,009,820
Interest on notes receivable, sales contracts, and other	810,922	8,247	2,379	6,033	7,187	15,170
Income from investments	429,131	53,428	36,394	73,439	78,872	82,507
Other income		166,593	236,794	400,970	349,719	169,121
	8,300,657	1,177,554	1,716,390	2,308,441	5,750,777	1,316,518
Deductions from earnings:						
Interest and other costs of debentures	2,549,626	190,970	311,320	636,948	1,137,811	309,143
Interest on notes payable	275,731	89,376	95,425	64,189	120,200	131,020
Operating expenses	379,107	223,356	271,632	236,894	363,636	247,404
Provision for losses on loans, etc.	257,201	36,000	60,000	142,000	100,000	80,000
Other deductions (additions)	391,773	(14)	(523)		(11,818)	35,728
	4,903,435	577,611	637,894	1,101,628	1,813,185	782,338
Net earnings for the year	3,397,222	600,000	1,078,496	1,206,813	3,937,592	534,180
Distribution of earnings:						
Transferred to surplus allocated to patrons	568,174	107,675	191,647	276,621	369,303	133,440
Federal franchise tax	606,114	40,180	103,623	131,175	131,363	75,724
Dividends declared	64,178	27,351	27,749	37,168	3,825	11,987
Patronage refunds	1,934,216	369,358	517,207	661,591	734,819	312,730
	3,652,621	643,900	778,586	1,106,485	1,239,810	533,981

Item	St. Louis	St. Paul	Omaha	Wichita	Houston	Berkley	Spokane
Earnings:							
Interest on loans to cooperative associations	\$3,757,516	\$2,915,600	\$2,758,182	\$1,379,118	\$1,625,472	\$3,795,915	\$1,526,562
Interest on notes receivable, sales contracts, and other	28,390	8,511	2,992	33,143	19,394	9,315	17,363
Income from investments	63,603	72,692	41,900	60,541	69,503	81,394	79,752
Other income	914,810	1,347,615	64,726	296,146	298,017	478,922	87,127
	4,805,609	4,344,228	2,907,810	1,769,208	2,022,386	4,375,546	2,000,922
Deductions from earnings:							
Interest and other costs of debentures	1,809,517	1,236,546	1,665,159	1,556,714	608,648	1,875,192	747,098
Interest on notes payable	266,445	113,747	1,002,217	1,211,112	60,364	172,126	160,000
Operating expenses	339,764	378,794	320,229	508,418	211,825	343,916	221,227
Provision for losses on loans, etc.	141,060	381,000	95,000	17,600	24,000	120,000	120,000
Other deductions (additions)	17,000	33,000	43	41,150		27,728	27,728
	2,563,822	2,143,071	3,073,727	2,475,294	1,112,967	2,539,318	1,276,100
Net earnings for the year	2,241,787	2,199,657	734,083	1,403,914	909,419	1,846,228	724,822
Distribution of earnings:							
Transferred to surplus allocated to patrons	552,919	549,164	151,258	272,925	275,441	450,189	175,776
Federal franchise tax	175,635	182,235	174,384	172,140	121,045	128,202	117,412
Dividends declared	12,900	46,123	22,352	29,445	25,145	7,390,206	6,000
Patronage refunds	4,407,293	7,418,085	403,649	673,799	600,784	1,228,491	266,177
	2,211,677	2,196,607	733,623	1,107,909	1,112,755	1,846,228	724,822

Banks for Cooperatives

TABLE 46.—Combined statements of earnings

Item	Year ended June 30, 1963	Year ended June 30, 1962
Earnings:		
Interest on loans to cooperative associations.....	\$34,513,962	\$32,171,261
Interest on notes receivable, sales contracts, and other.....	158,536	85,130
Income from investments.....	1,349,545	1,234,730
Other income.....	38,449	37,774
	<u>36,060,492</u>	<u>33,528,895</u>
Deductions from earnings:		
Interest and other costs of debentures.....	15,738,693	13,321,908
Interest on notes payable.....	1,036,528	1,394,915
Operating expense.....	3,619,735	3,577,364
Provision for losses on loans, etc.....	1,651,300	1,257,300
Other deductions.....	210,196	89,458
	<u>22,456,452</u>	<u>19,640,945</u>
Net earnings for the year.....	<u>13,604,040</u>	<u>13,887,950</u>
Distribution of earnings:		
Transferred to surplus allocated to patrons.....	2,128,249	3,956,196
Federal franchise tax.....	2,170,283	2,250,387
Dividends declared.....	372,936	405,611
Patronage refunds.....	8,932,572	7,275,726
Total.....	<u>13,604,040</u>	<u>13,887,950</u>

TABLE 47.—Combined statements of surplus

Item	Year ended June 30, 1963	Year ended June 30, 1962
Surplus reserved by statute.....	<u>\$88,111,198</u>	<u>\$88,111,198</u>
Surplus allocated to patrons:		
Balance, beginning of year.....	\$17,542,510	\$13,600,203
Transferred from net earnings.....	2,128,249	3,956,196
Retired.....	(29,844)	(13,889)
Balance, end of year.....	<u>19,640,915</u>	<u>17,542,510</u>
Surplus, end of year.....	<u>107,752,113</u>	<u>105,653,708</u>

Banks for Cooperatives Investment Fund
(Agricultural Marketing Act Revolving Fund)

TABLE 48.—*Statements of condition*

ASSETS	June 30, 1962		June 30, 1962	
Cash with U.S. Treasury.....		\$55,162,500		\$43,153,000
Investments in capital stock:				
District banks for cooperatives.....	\$57,937,500		\$66,917,000	
Central Bank for Cooperatives.....	36,900,000	94,837,500	59,500,000	106,517,000
Total assets.....		150,000,000		150,000,000
LIABILITIES				
Capital.....		150,000,000		150,000,000
Total liabilities.....		150,000,000		150,000,000

Defendant's Exhibit 2

INVOICE

Telephone LD-9918

Inv. No. 35.90

ASSOCIATED COOPERATIVES, INC.

750 West Twentieth Avenue
Sheffield, Alabama

Date: May 21, 1964.

To Mississippi Federated Cooperatives (AAL)

Post Office Box 449

Jackson 5, Mississippi

Remittance must be payable at par in New York exchange or it's
equivalent to Associated Cooperatives, Inc.To bill your purchase of ACI stock in New Orleans Bank for
Cooperatives as follows:B stock—par value, \$15,000.00. Purchased by agreement
with Mr. H. L. Hodges, Vice President. \$15,000.00C stock—par value, \$27,411.31. Purchased by your bid of
March 30, 1964. 12,000.00Certificates for the above stock were not issued by the Bank,
as it was pledged as loan collateral and has been held pending
this ACI liquidation sale.

TOTAL \$27,000.00

Paid 5-29-64, \$27,000, Ck. 02 1414.

CAUSE NO. 2113 & 2114 CW

EXHIBIT 2-2 Evidence

WITNESS Hiram Polk

PAGES

Nov. 7, 1968,

United States District Court,

Southern District of Mississippi,

WILLIAM A. DAVIS, Reporter.

Defendant's Exhibit 3

STOCK IN NEW ORLEANS BANK FOR COOPERATIVES

Date	Voucher No.	Quantity	Description	Debits	Credits	Balance
Jul 22 63	OV 31		To rec NOBC class C stock patronage refund for year ended June 30, 1963.	58,026.97		400,711.50
Oct 16 63	16,542		New Orleans Bank for Co- ops—payment on interest on loans from July 1, 1963, to Oct. 1, 1963, class C stock.	11,682.24		412,393.74
Jan 15 64	18,066		New Orleans Bank for Coops.	14,234.24		426,627.98
Apr 15 64	19,528		New Orleans Bank for Coops Class C stock.	13,575.50		440,203.48
May 29 64	21,414		Associated Cooperatives Inc.: B stock par values.	15,000.00		
May 29 64	21,414		C stock par values.	12,000.00		467,203.48
May 31 64	OV 437		To bring C stock purchased from Associated up to par.	15,408.39		482,611.87

Defendant's Exhibit 4

NEW ORLEANS BANK FOR COOPERATIVES
FIFTH FARM CREDIT DISTRICT, ALABAMA-MISSISSIPPI-
LOUISIANA

P.O. Box 50072, NEW ORLEANS, LOUISIANA 70150.

May 20, 1964.

Mr. E. G. SPIVEY,

General Manager, Mississippi Federated Cooperatives (AAL),

P.O. Box 449,

Jackson 5, Mississippi

DEAR MR. SPIVEY: In accordance with instructions contained in your letter of May 19, and in accordance with the assignment by Associated Cooperatives, Inc., in their letter of May 18, we have made the following entries on our records:

150 shares of Class B stock of the bank, with a par value of \$100 per share in the name of Associated Cooperatives, Inc., has been cancelled and Class B stock in a like amount has been issued in the name of Mississippi Federated Cooperatives (AAL)

We will retain this Class B stock as automatic security for present loans due by Mississippi Federated Cooperatives (AAL), and this letter will serve as our receipt for the retention of this stock.

We are also marking our records to transfer \$27,411.31 of Class C stock in the bank, and \$9,274.79 of allocated surplus in the bank presently in the name of Associated Cooperatives, Inc., plus any accrued Class C patronage and allocated surplus for the fiscal year 6/30/64 from Associated Cooperatives, Inc. to Mississippi Federated Cooperatives (AAL). The accrued Class C patronage and allocated surplus for fiscal year 6/30/64 will be very minor since the interest on Associated's loans during that year amount to \$19.42 and we guess that the patronage and allocated surplus will not amount to more than 25 percent of this figure. We will furnish you the positive figure when we have closed our books for 6/30/64.

Very truly yours,

N. F. PENDLETON,
President

NFP:fm

cc: H. L. Hodges (2)

L. J. Mauffray

Defendant's Exhibit 5

RL-9888, 9889

No.	Item	Amount
(a)-----	Class A stock outstanding 6/30/58 (Attachment No. 1).	\$6,517,000.
(b)-----	Class A stock retired during year ending 6/30/58 (Attachment No. 2).	229,800.
(c)-----	Assume remainder of Class A stock is retired at rate retired in year ending 6/30/58: years to retire would be (a) divided by (b).	28.6 years.
(d)-----	Franchise tax paid in year ending 6/30/58 (Attach. No. 2).	\$50,101.
(e)-----	Adjustment for reduced franchise tax—\$50,101 divided by 5% equals \$1,002,020, the amount of Class A stock outstanding when interest rate determines amount of franchise tax. \$1,002,020 divided by \$229,800 equals 4.4 years the period affected by change in franchise tax. 4.4 years \times \$50,101 \times $\frac{1}{2}$ equals \$110,220, the franchise tax saved and applicable to retiring Class A stock. \$110,220 divided by \$229,800 equals the shortening of retiral period through application of franchise tax savings to retirement.	0.5 years.
Note: By formula the foregoing is developed as follows:		
$\frac{(d) \times 1/5\%}{(b)} \times \frac{(d)}{2} \times \frac{1}{(b)}$		
(f)-----	Years required to retire Class A stock: (c)—(e)	28.1 years.
(g)-----	Annual amount applicable to retirement of Class B and Class C stocks: \$229,800 plus \$50,101 franchise tax, or (b) plus (d).	\$279,901.
(h)-----	Class B stock outstanding 6/30/58 (Attachment No. 1).	360,666.
(i)-----	Years to retire Class B stock: (h) divided by (g)	1.3 years.
(j)-----	Class C stock outstanding plus allocated surplus 6/30/58 (Attachment No. 1).	\$700,850.
(k)-----	Years to retire Class C stock and pay out allocated surplus: (j) divided by (g).	2.5 years.
(l)-----	Years from 6/30/58 to retirement of Class C stock issued in year ending 6/30/58: (f) + (i) + (k).	31.9 years.
(m)-----	Annual rate for discounting back par value of Class C stock (l) years in future to 6/30/58.	12%.
(n)-----	Present value of \$1.00 at (m) rate of interest (l) number of years in the future.	\$0.0269.
(o)-----	Ratio of Class C stock issued plus surplus allocated year ending 6/30/58 to Class C stock alone (Attach. No. 2).	1.27.
(p)-----	Present value factor for \$1.00 multiplied by ratio of Class C stock plus allocated surplus to Class C stock alone: (n) \times (o).	\$0.0342.
(q)-----	Estimated fair market value as of 6/30/58 of one \$100 par share of Class C stock issued in year ending 6/30/58: (p) \times 100.	\$3.42.

BALANCE SHEET ITEMS

BANK FOR COOPERATIVES IN NEW ORLEANS						
Item	To 6/30/63	To 6/30/62	To 6/30/61	To 6/30/60	To 6/30/59	To 6/30/58
Loans Outstanding To Coops.	27,939,959	19,627,247	20,334,247	19,881,001	21,828,383	19,675,177
Participating Certif. Outstanding	7,170,320	3,052,811	2,221,723	3,110,193	4,665,758	332,600
Net	20,769,639	16,574,436	18,112,524	16,770,808	17,162,625	17,362,577
Capital Stock						
Class A	4,820,000	5,270,000	5,620,000	5,970,000	6,270,000	6,517,000
Class B	899,562	402,119	403,747	405,431	357,820	360,666
Class C	2,681,548	2,158,356	1,727,162	1,291,053	881,454	537,525
Total	7,966,110	7,830,475	7,753,009	7,666,484	7,553,300	7,490,132
Surplus-Reserved Allocated	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888	3,627,888
Total	711,949	571,958	463,455	348,274	254,470	163,325

FOR ALL THIRTEEN BANKS FOR COOPERATIVES

Loans Outstanding To Coops.	700,561,449	672,366,803	594,548,829	550,712,891	525,880,724	408,257,152
Participating Certif. Outstanding	13,461	18,367	-	-	-	-
Net	700,548,988	672,344,436	594,548,829	550,712,891	525,880,724	408,257,152
Capital Stock						
Class A	80,911,100	94,837,500	106,817,000	118,286,900	126,337,800	134,798,700
Class B	11,229,389	12,235,783	13,186,012	14,007,649	14,568,539	14,777,312
Class C	68,830,284	54,663,776	42,407,410	31,623,529	23,244,786	15,303,640
Other	32,300	89,500	178,400	253,443	411,337	571,474
Total	161,023,073	161,826,799	162,608,822	164,175,321	164,553,512	165,657,136
Surplus-Reserved Allocated to Patron	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198	88,111,198
Total	17,640,915	17,542,510	13,600,203	10,099,051	7,720,210	5,077,025

BALANCE SHEET ITEMSBANK FOR COOPERATIVES IN NEW ORLEANS

Item	To 6/30/57	To 6/30/56	Class C Stock Outstanding Plus Surplus	
			Allocated To Patrons	
Loans Outstanding To Coops.	\$12,207,957	\$9,513,942	Year Ending June 30, 1956	Total \$114,351
Participating Certif. Outstanding	601,800	751,800		
Net	12,206,157	8,761,642	1957	332,325
Capital Stock			1958	700,850
Class A	6,746,800	6,728,100	1959	1,155,924
Class B	364,702	360,460	1960	1,639,327
Class C	287,863	86,590	1961	2,192,717
Corp. Other Assets	135,204	201,846	1962	2,736,314
Total	7,535,191	7,576,796	1963	3,392,197
Surplus-Reserve	3,627,888	3,627,488		
Allocated To Patrons	94,461	27,761		

FOR ALL THIRTEEN BANKS FOR COOPERATIVES

Loans Outstanding To Coops.	384,328,803	348,076,139
Participating Certif. Outstanding	2,790	6,532
Net	384,325,833	348,067,607
Capital Stock		
Class A	141,673,200	147,360,000
Class B	15,339,393	15,601,475
Class C	8,703,316	2,820,037
Corp. Other Assets	1,229,694	2,259,208
Total	166,945,613	168,040,720
Surplus-Reserve	88,111,198	88,111,198
Allocated To Patrons	2,755,071	977,094

BANK FOR COOPERATIVES IN NEW ORLEANSCHANGES IN CLASS A AND CLASS C STOCKS AND DISPOSITION
OF SAVINGS, YEARS ENDING JUNE 30, 1957-1963

Year Ending	Class A Stock Retired	Class C Stock Issued	Surplus Allocated to Patrons	Franchise Tax	Dividends Paid	Patronage Refund
June 30, 1957	\$ 181,300	\$ 201,274	\$ 66,700	\$ 98,590		
1958	229,800	249,661	68,864	50,101		
1959	247,000	343,929	91,145	56,627	10,735	206,073
1960	300,000	409,599	93,204	60,543	11,826	221,644
1961	350,000	438,209	115,181	74,507	12,112	261,107
1962	350,000	429,074	114,503	75,233	12,063	256,409
1963	390,000	523,192	133,491	75,724	11,907	312,759
June 30, 1957 to 1963	Class C Stock Issued Plus Surplus Allocated	Ratio of Class C Stock Plus Allocated Surplus to Class C Stock Alone				
1957	\$ 267,974	1.33				
1958	318,525	1.27				
1959	435,074	1.27				
1960	503,403	1.24				
1961	553,390	1.32				
1962	543,597	1.30				
1963	656,683	1.26				

INTEREST RATE ON U.S. GOVERNMENT SECURITIES

A long upward trend in interest rates commenced soon after end of World War II. Various explanations are given for local peaks and sags but the trend has been clearly evident. Annual interest rates (or yields) for U.S. Government securities have been:

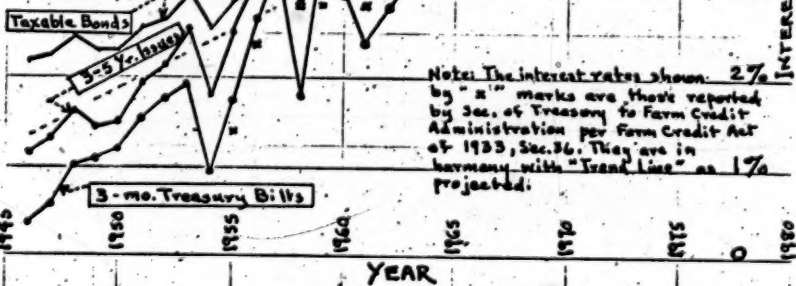
Year	3-mo. Treasury Bills	3-5 Year Issues	Taxable Bonds	Year	3-mo. Treasury Bills	3-5 Year Issues	Taxable Bonds
1946	0.375	1.16	2.19	1958	1.837	2.70	3.43
1947	0.594	1.32	2.25	1959	3.405	4.33	4.08
1948	1.040	1.62	2.44	1960	2.743	3.79	4.02
1949	1.102	1.43	2.31	1961	2.378	3.60	3.90
1950	1.218	1.50	2.32	1962	2.778	3.57	3.75
1951	1.532	1.93	2.57	1963	3.157	3.72	4.00
1952	1.766	2.13	2.68	1964	3.597	4.06	4.15
1953	1.731	2.56	2.74	1965	3.754	4.22	4.21
1954	0.753	1.82	2.55	1966	4.881	5.16	4.65
1955	1.753	2.50	2.84	1967	7.321	5.07	4.85
1956	2.658	3.12	3.08	4-12-68	5.309	5.48	5.21
1957	3.267	3.62	3.47				

Source: Economic Indicators, prepared for Joint Economic Committee, U.S. Congress

Besides the definitely upward trend the table reflects two more characteristics of interest rates on Treasury securities (and of money market rates in general):

(1) When interest rates are low—i.e., in period of money ease—the spread between rates for short and long term maturities is relatively large and this spread decreases as interest rates increase, and (2) in

times of very high interest rates, rates for short term maturities may be higher than rates for long term maturities of equal quality.



ATTACHMENT No. 4

Bank For Cooperatives In New Orleans

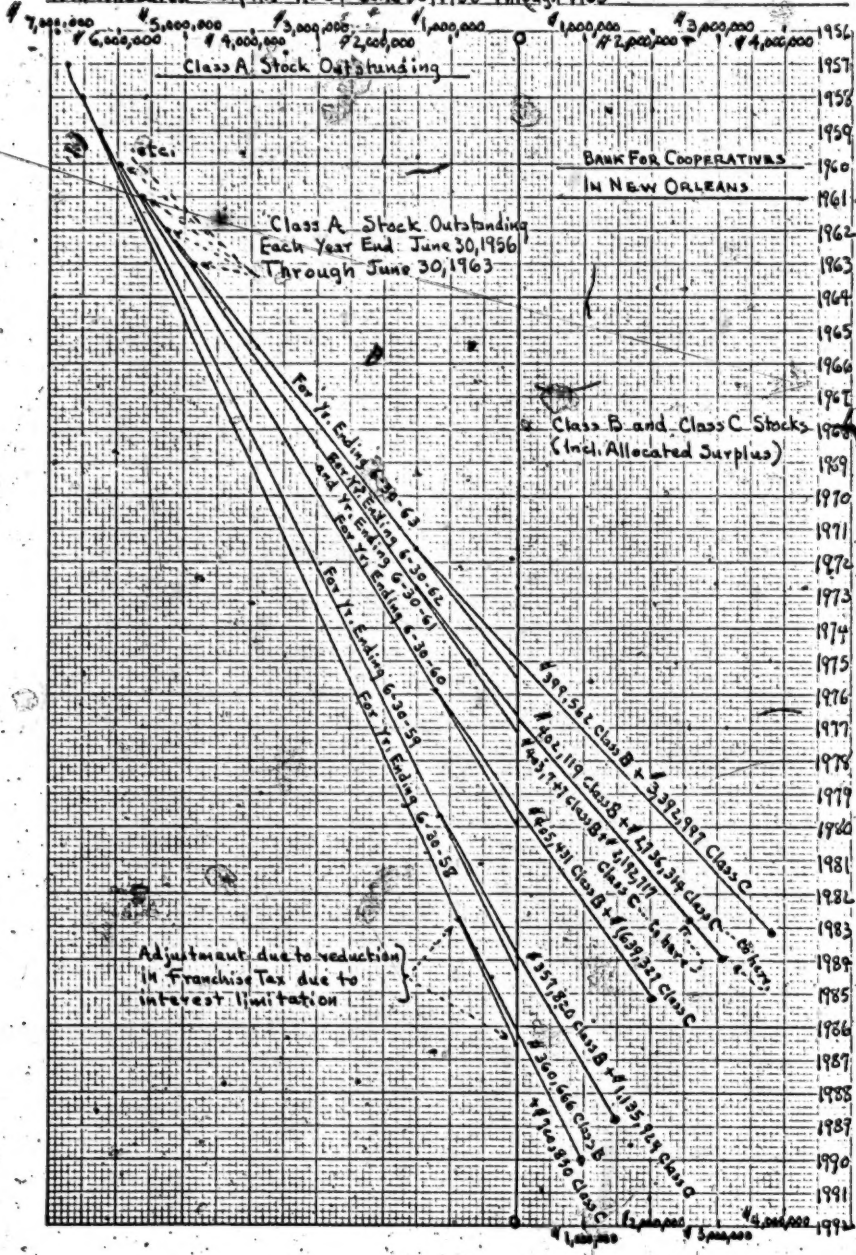
Tabulation Showing Certain Data Used In Arriving
At Fair Market Value Estimates For Class C
Stock Issued In Years Ending June 30, 1958 Through 1963.

Item No.	For Class C Stock Issued In Year Ending						
	6/30/58	6/30/59	6/30/60	6/30/61	6/30/62	6/30/63	
(a)	\$6,517,000	\$6,270,000	\$5,970,000	\$5,620,000	\$5,270,000	\$4,880,000	(ATTACH. No. 1)
(b)	\$227,800	\$247,000	\$300,000	\$350,000	\$350,000	\$370,000	(ATTACH. No. 2)
(c)	28.6 yrs.	25.3 yrs.	19.9 yrs.	16.1 yrs.	15.1 yrs.	12.5 yrs.	(a) ÷ (b)
(d)	\$50,101	\$56,627	\$60,543	\$74,507	\$75,233	\$75,724	(ATTACH. No. 2)
(e)	0.5 yrs.	0.5 yrs.	0.4 yrs.	0.5 yrs.	0.5 yrs.	0.4 yrs.	(d) × (c) ÷ (b)
(f)	28.1 yrs.	24.8 yrs.	19.5 yrs.	15.6 yrs.	14.6 yrs.	12.1 yrs.	(c) - (e)
(g)	\$279,901	\$303,627	\$360,543	\$424,507	\$425,233	\$465,724	(b) + (d)
(h)	\$364,666	\$357,820	\$405,431	\$403,747	\$402,119	\$377,562	(ATTACH. No. 1)
(i)	1.3 yrs.	1.2 yrs.	1.1 yrs.	1.0 yrs.	0.9 yrs.	0.9 yrs.	(h) ÷ (g)
(j)	\$700,850	\$1,135,724	\$1,639,327	\$2,172,717	\$2,736,314	\$3,372,777	(ATTACH. No. 1)
(k)	2.5 yrs.	3.7 yrs.	4.5 yrs.	5.2 yrs.	6.4 yrs.	7.3 yrs.	(j) ÷ (g)
(l)	31.9 yrs.	29.7 yrs.	25.1 yrs.	21.8 yrs.	21.9 yrs.	20.3 yrs.	(f) ÷ (i) + (k)
(m)	12%	10%	9%	8%	7%	6%	
(n)	\$0.0269	\$0.0290	\$0.1149	\$0.1268	\$0.2273	\$0.3065	
(o)	1.27	1.29	1.24	1.32	1.30	1.26	(ATTACH. No. 2)
(p)	\$0.0342	\$0.0750	\$0.1413	\$0.2465	\$0.2760	\$0.3865	(n) × (o)
(q)	\$3.42	\$7.50	\$14.13	\$24.65	\$29.60	\$38.65	(p) × 100

Item (q) is estimate of fair market values of Class C stocks issued in years ending June 30, 1958 through 1963, as of June 30, 1958 through 1963, respectively.

Note: Period of time during which franchise tax reduction due to interest limit (est. at 5%) contributes to revival of Class A stock is equal to $[(d) ÷ 5\%] ÷ (b)$ in years, and period for years ending June 30, 1958 - 1963 is 3.8 yrs., 4.6 yrs., 4.0 yrs., 4.3 yrs., 4.3 yrs., and 3.9 yrs., respectively.

Chart Showing Estimated Trends For Retention Of All Class A, B, & C Stocks Outstanding And Allocated Surplus As Of June 30, 1958 Through 1963



8

DEPOSITION OF WALTER C. VERLANDER

Q. What is a bank for cooperatives, Mr. Verlander?

A. A bank for cooperatives?

Q. Yes.

A. I would say it's a bank or institution, financial institution, that was set up under the Farm Credit Act of 1933 to finance eligible farmer cooperatives.

Q. Now how does a Bank for Cooperatives differ from a commercial bank?

9 A. It differs in, I would say, it has no cashiers, it takes no deposits, and in that respect it differs from a commercial bank, but it does make loans to borrowers.

Q. All right, sir. Now, if you will, will you please outline the chain of command in a Bank for Cooperatives, if you will.

A. In our bank?

Q. In the whole system of which the New Orleans Bank for Cooperatives is a part.

A. You mean the organizational structure for the entire Farm Credit System?

Q. Yes, very briefly. I don't mean for you to go into any great detail about that.

A. First, at the top you would have the Federal Farm Credit Board. It's composed of 13 men. Now, this Board, their primary responsibility of course is to hire and employ a chief administrator officer, and that chief administrator officer is the governor of farm credit. The governor has under him an assistant governor and a deputy director for each bank service,

10 that would be the Federal Land Bank the Federal Intermediate Credit Bank and the Bank for Cooperatives. That is the organizational structure, I would say,

at the National level. Now, the system is composed of 37 banks, that would be 12 regional land banks, 12 regional federal intermediate credit banks, and 12 regional Banks for Cooperatives and 1 central bank for cooperatives which is located in Washington, D.C. Now, at the regional level we have in this district a 7-man board of directors, and this 7-man board serves as a district board as well as the same board for each of the three banks that are housed in this district, and this board elects the President, and senior officers, other senior officers, to manage, if you want to use that term to manage the banks. Now, this is off the record.

(Discussion off the record.)

Q. As I understand it, Mr. Verlander, the District Farm Credit Board acts as a board of directors for the regional federal land bank, for the regional bank for cooperatives, and the regional production credit association, is that right?

11 A. The regional federal intermediate credit bank.

Q. Yes.

A. Rather than a production credit association.

Q. Now, how are the members of the district farm credit boards selected?

A. Our board at the present time is composed of 7 members, 2 are elected by the stockholders of the federal land bank association, 2 are elected by the stockholders of the Production Credit Association, 2 are elected by the eligible borrowers of the bank for cooperatives, the New Orleans Bank for Cooperatives, and 1 is appointed by the governor of the Farm Credit Administration.

Q. Now, you said, I believe, that is presently true.

A. Yes, sir.

Q. For how long has it been true? I am asking that now.

A. With regard to the Bank for Cooperatives, the New Orleans Bank for Cooperatives, in 1967 the stockholder borrowers of the bank became—could elect the second director.

Up until that time they could elect only 1 director.

12 Q. What happened, Mr. Verlander, that entitled the Bank for Cooperatives to elect an additional director?

A. The borrowers at that time acquired sufficient stock in the Bank to become eligible, to make that second director's selection.

Q. Now, when you say they obtained,—did you say the Cooperatives acquired sufficient stock?

A. Yes, sir.

Q. When you say that the Cooperatives acquired sufficient stock, what kind of stock do you refer to?

A. Two classes of stock that they can hold, and own, one of them is a Class B stock, and the other is a Class C stock in the Bank.

Mr. RANEY. Who elected the second director prior to 1967, this one that—

The WITNESS. You mean a second director in the Bank for Cooperatives?

Mr. RANEY. Right, sir.

13 The WITNESS. The other was—he was appointed at that time by the Governor of Farm Credit.

By Mr. WARREN:

Q. Is any officer, director, or stockholder of Mississippi Chemical Corporation or Coastal Chemical Corporation an officer or director of this Bank?

A. Yes, sir.

Q. And what is his name, please, sir?

A. Ernest Spivey, S-p-i-v-e-y, is a director, of Mississippi Chemical and Coastal, and he is also on our Board. There is also Mr. F. A. Graugnard is a director on Coastal's Board and he is also a director of our Bank.

Q. How do you spell that gentleman's last name, sir?

A. G-r-a-u-g-n-a-r-d, F. A.

Mr. WARREN. Off the record.

(Discussion off the record.)

By Mr. WARREN:

Q. When, if you know, were these two gentlemen made directors of this Bank, or I assume when you say they are
14 directors of this Bank, let me clear up that if there is any confusion about it. These two gentlemen that you refer to, that is Mr. Spivey and Mr. Graugnard: they are members of the District Farm Credit Board, is that correct?

A. That's right, the 5th Farm Credit District Board.

Q. When, if you know, did they become members of that Board?

A. I think it was Spivey, he has served on the Board for 10 years, if I recall properly, and I believe Mr. Graugnard has been on the Board 7 years.

Mr. WARREN. Off the record.

(Discussion off the record.)

By Mr. WARREN:

Q. You have stated, Mr. Verlander, how the members of the District Farm Credit Board are selected. Can you state how the national farm credit board is selected or how members of that Board are selected?

A. Do you mean the Federal Farm Credit Board?

Q. Yes, sir.

15 A. Our district would be a good example or starting point because the other districts follow the same procedure.

Q. All right.

A. The stockholders of the Federal Land Bank Associations will nominate an individual to serve on that Board from his district. The production credit associations will nominate a man to serve on that Board from his district. The Cooperatives Associations will also nominate a man to serve on that Board from his district. These 3 men then are reviewed by the President of the United States, and 1 of the 3 would be selected. Now, in cases where, let's say, the Bank for Cooperatives does not nominate a man, then he would only have a choice from 2, you see.

Q. Had it ever occurred that 1 of these 3 different kinds of Cooperatives did not nominate or propose the nomination of a member, propose the appointment of a member?

A. No. You said "oppose"?

Q. Propose.

A. Oh, no.

16 Q. Has a nominee of the Bank for Cooperatives of this district ever proposed a member of the National Board who was ultimately appointed to it, to the Board?

A. Would you repeat the question, please.

Q. In other words, all I have asked you is you stated that Banks for Cooperatives, of the Cooperatives, propose 1 member of the Board. That is right, isn't it?

A. They propose a man, they nominate a man, right.

Q. For the President's consideration?

A. Yes, sir.

Q. Has the man proposed by the Cooperatives ever been appointed as a member of the Federal Farm Credit Board?

A. From our district?

Q. Yes.

A. No.

19 Q. Has the Farm Credit Administration promulgated rules regulating the circumstances under which loans could be made by the Bank to individual borrowers?

20 A. We have certain eligibility requirements that borrowers will have to meet in order to obtain a loan from the bank.

Q. Are those eligibility requirements set down in writing somewhere?

A. Yes, they are.

Q. What is that called?

A. It is the Agricultural Marketing Act.

Q. Has the Farm Credit Administration or any other agency or department of the United States issued regulations relating to eligibility requirements for making loans and for the operation of banks for cooperatives generally?

A. The Farm Credit Administration has picked up the eligibility requirements that are spelled out under the Agricultural Marketing Act as amended. Now, as to the operations of the banks, yes, we have a manual that covers certain operational areas in the bank. Those would be the regulations that you referred to.

Q. Who put out the manual?

A. The Farm Credit Administration.

Q. The New Orleans Bank for Cooperatives follows this manual as a policy matter in making loans, does it, Mr.

21 Verlander?

A. It follows the manual in all of the areas, operational areas, that are covered.

23 Q. It is true, is it not, Mr. Verlander, that in order
for a qualified borrower to borrow money or to obtain the
agreement of the Bank to loan money, the borrower
24 must agree to purchase certain—a certain amount of
Class C stock of the bank?

A. In order to qualify for a loan, the borrower must acquire 1 qualifying share of Class C stock, par value \$100, then as the condition of the loan proceeds, he acquires additional C stock through quarterly investments.

Q. How is the amount of the Class C stock that the borrower is required to acquire determined?

A. Our interest override amounts to 10% of the interest paid at this time, but at the time that Mississippi Chemical and Coastal Chemical were purchasing this stock in 1961, 1962, and 1963, the interest override amounted to 15% of the interest paid.

Q. Now, when you say, "interest override," what do you mean by that Mr. Verlander?

A. Well, this is the cash money that a cooperative pays into the Bank for C stock. It also gets additional C stock from patronage, but that is something else.

Q. When you use the term "interest override" do you mean to indicate that the amount of money that is paid in
25 to acquire Class C stock is increased?

A. No, it is determined, the amount of money is determined by the amount of interest that was paid, and, for example, if the Cooperative was billed at the end of the year for \$1,000 of interest, it would also be billed for, at that time, \$150 of—billed for that amount \$150 which would be used to purchase this required C stock investment in the Bank.

Q. Is this term "interest override" to your knowledge used in any of the applications to Banks for Cooperatives or any regulations thereunder are in any manual issued by the Farm Credit Board or Farm Credit Administration?

A. No, we refer to it in our district this way.

Q. Now, you have said that the percentage of interest that was required to be used to pay for Class C stock was 15% during the years—

A. Yes.

Q. Now how was that 15% arrived at? As I understand it, a Bank for Cooperatives may determine that amount,
26 determine that the amount of the purchase of Class C stock may vary from 10 to 25%. Is that correct?

A. That is correct.

Q. And you said, so far as the New Orleans Bank for Cooperatives was concerned, the percentage was 15%?

A. Yes, sir.

Q. During 1961, 1962, and '63?

A. Yes, sir.

Q. My question to you is how was that 15% arrived at?

A. It was arrived at after the Board made its policy determination as to how long a period of time it wished to take to retire the Government Class A stock, they then determined or made a policy determination to select an override, this 15% override, on a basis of meeting that goal for retirement of Government capital.

Q. When was the first time that the District Farm Credit Board made a policy decision as to when Government Class A stock should be retired in the case of the New Orleans Bank for Cooperatives?

A. Immediately when the Farm Credit Act was
27 amended.

Q. That is 1955?

A. In 1956, when it went into effect.

Q. You have been good enough to get out the minutes of the Board of Directors for me. To your knowledge, would the policy determination as to the length of time it would be required to pay off or retire the Class A stock be reflected in those minutes someplace?

A. Yes, sir, it would, but I think the fixed schedule for retirement of Government capital came a few years—a little time later than when the Act went immediately into effect.

Q. Now what was the approximate time lapse, if you know?

Mr. SATTERFIELD. Off the record.

(Discussion off the record.)

By Mr. WARREN:

Q. When did the thing become effective, do you recall right offhand, when did the—

A. January 1, 1956.

Q. We are talking about the 1955 amendments which
28 became effective as of—

A. January 1, 1956.

Mr. SATTERFIELD. Off the record.

(Discussion off the record.)

The WITNESS. May 20, 1959.

By Mr. WARREN:

Q. Was May 20, 1959, the first time that the District Farm Credit Board made a policy determination as to the length of time it would take to retire the Class A stock of this bank?

A. I would say that was the first time that it was reduced to a fixed schedule, yes, or a plan that would be in black and white. Up until that time it was oral, not reduced to writing.

Q. I believe that that resolution indicates that as a policy matter the Board indicated that the stock should be retired in about 20 years, is that correct?

A. That is correct.

Q. Under the basic Act, as I understand it, while the
29 District Farm Credit Board was authorized to determine the percentage of interest that would be used to—for the purpose of Class C stock, the Farm Credit Administration reserved the right to approve that percentage, did it not, Mr. Verlander?

A. Yes, sir.

30 Q. Has the New Orleans Bank for Cooperatives had occasion to acquire Class C stock of the Central Bank for Cooperatives?

A. Yes.

Q. Under what circumstances, please, sir?

A. C stock as distributed to our bank since the Central Bank operates as a Cooperative and we share in any earnings distribution of the bank, and that earnings distribution has been in the form of C stock.

31 Q. At sometime did the New Orleans Bank for Cooperatives have to buy Class C stock of the Central Bank for Cooperatives?

A. Yes, sir.

Q. Why did it have to buy such stock?

A. We bought stock in the Central Bank so that it can retire the Government capital in its bank.

Q. Has the New Orleans Bank for Cooperatives received patronage dividends from the Central Bank for Cooperatives in the form of C stock?

A. Yes, sir.

Q. Is the New Orleans Bank for Cooperatives accountable to the Farm Credit Administration or some other Federal Department or agency?

A. Well, —

Q. That is a pretty wide question, but is the Bank required to file financial statements and other reports with some other — with some agency or department of the Federal Government?

A. We filed financial reports periodically with
32 the Farm Credit Administration. We also have a resident examiner in the Bank that checks on the financial condition of the Bank regularly.

Q. Without going into complete detail, what sort of financial statements and reports does this bank file with the Farm Credit Administration?

A. Financial and operating statements, balance sheets, operations statements.

Q. Does it do that on a monthly basis?

A. Yes, sir.

Q. It's not done more frequently than monthly, is it?

A. Some records are daily on loan transactions; sir, with the Farm Credit and the Central Bank.

33 Q. Let me try to make it a little bit simpler. That is a little wordy, I agree. You have stated previously that this Bank purchased Class C stock from the Central Bank for Cooperatives, did you not, sir?

A. Yes, sir.

Q. Did this Bank in reports filed with the Farm Credit Administration deduct the cost of that stock as an operating expense?

A. No.

Q. Did it deduct it as interest?

A. No.

Q. Did it deduct it as a loss entered into for profit?

A. No.

Q. Were the amounts paid to this Bank, its borrowers for Class C stock included as interest income in any financial statements filed by this Bank with the Farm Credit Administration?

A. You mean the quarterly investment in C stock?

Q. Yes.

A. No.

Q. Has the Farm Credit Administration or any other Federal agency or department, so far as you know, issued instructions, rules or regulations as to how such items should be treated on these financial statements?

34

A. No.

Q. Then—

A. Wait a minute now. Let's clarify the question a little bit. This is with regard to the borrowers, right?

Q. No, sir, the question was directed to two things, first of all this Bank bought C stock from the central bank for co-operatives, and I believe you stated that the cost of that C stock that this Bank acquired from the Central Bank was not deducted as an operating expense. That is one aspect of the question. On the other hand I believe you also stated the interest, what you referred to as interest override, I asked you if in any of the these financial reports filed with the Farm Credit Administration whether that amount was included as interest income. I think your answer to that was no. I then asked

35

you if there were any rules or regulations telling you how you had to handle it and I think you said the answer to that was no. My summary has been fair so far?

A. Fair.

Q. Now, the next question is who made the decision as to how these sorts of transactions would be handled on the financial records submitted to the Farm Credit Administration?

A. I would think you had better ask our Treasurer that question, but I would say that what is covered in our manual as to also the accounting procedures for the operation of the Bank as sent down to us by Farm Credit, we followed those standard accounting procedures which would include the handling of some accounts.

Q. So far as you know, Mr. Verlander, and I realize perhaps you don't get into all of this detail in your office, but as I understand your answer it was treated according to the provisions of the manual or according to the standard accounting procedures. Is that correct?

A. Yes, sir.

36 Q. As you no doubt know, Mr. Verlander, the statutory provisions setting up the Banks of Cooperatives provide that in certain instances Class B stock may be converted into Class C stock in order to meet the requirements of the purchase of Class C stock.

A. Yes.

Q. Has any borrower of this Bank, to your knowledge, ever converted Class B stock to Class C stock?

A. Many of them.

Q. Was the conversion on a dollar for dollar basis?

A. The conversion was to meet the amount of the interest override or quarterly investment.

Q. Yes, I understand that, but the Class B stock, as I understand it, is issued at par, and par is described as being \$100. Is that correct?

A. Yes, sir.

Q. Now, Class C stock is also issued at \$100 par. Is that not correct?

A. We don't issue the C stock as such, no.

Q. When you say—

37 A. We have no certificate that we issue. We make this a credit on the books of the Bank, this investment.

Q. Well, at what rate do you credit it?

A. Dollar for dollar.

Q. You say the Bank does not actually issue Class C stock certificates?

A. That is correct.

Q. In making credit to the accounts of the various borrowers, does it credit the borrower with \$100 when it obtains a—

A. When it has paid that amount in, yes.

Q. Or obtains a patronage refund, is that not correct also?

A. That is correct, but we are only talking about conversion for actual purchase of C stock in the Bank, that is, conversion of B to C.

Q. All right sir, but the rest of my question is this: if an individual borrower owned one class or one share of Class B stock, and he converted it for purposes of meeting the loan requirements, what dollar value in terms of Class C stock would be assigned to the C stock after the conversion?

A. \$100.

38 Q. Was that true in 1961, 1962, and 1963?

A. Yes, sir.

Q. Is there any written policy requiring the conversion on a dollar for dollar basis that might be found in the Board of Directors minutes or in the manual, I suspect, or perhaps elsewhere?

A. Well, in the Bank's by-laws that it provides for conversion from B to C stock.

Q. Of course we can look at the by-laws, but does it—do the by-laws provide that it shall be converted on a dollar for dollar basis?

A. Yes, yes, I would say so.

Q. Does the Bank that is the New Orleans Bank for Cooperatives, does the Bank maintain a reserve of some sort for losses that might be sustained on loans to borrowers?

A. Yes.

Q. How is the amount of that reserve determined?

A. We have a reserve policy that we automatically charge monthly operations. Right at the present time, it's \$10,000 a month.

Q. Without respect to the amount of the outstanding loans?

39 A. This is on the present outstanding loans, yes. At the time of '61, '62 and '63 we had a different rate of reserve for take out each month.

Q. Do you recall what the rate was?

A. I believe it was \$5,000 per month.

Q. Now how was that amount determined, though, Mr. Verlander?

A. Based on the outstanding loans.

Q. Was it based on experience of losses?

A. Loss experience would enter into it, yes.

Q. What other factors entered into this?

A. The current classifications of the loan, the economic conditions that you face, these would have a bearing on what the monthly charge would be.

Q. You said, I believe, at least in part the amount of the reserve was determined by experience, at least in part?

A. Yes, sir.

Q. In that connection has the New Orleans Bank for Cooperatives sustained losses from borrowers on account of defaulting in payment of loans?

A. Yes, I would say that our loss experience is higher
40 than other district banks.

Q. In those cases where the bank has sustained losses, what action if any did the bank take to minimize the extent of its loss?

A. Well, of course, you never want to take a loss if you can help it.

Q. Of course.

A. And we worked with a borrower constantly to minimize this. When we see one developing, when we see a borrower in trouble, we work with a borrower.

Q. But when you work with him to no avail and it becomes apparent that the borrower is not going to meet his obligation, what does the Bank do or what has been done?

A. When all hope is lost, is that what you mean?

Q. Yes.

A. Well, there is only one thing you can do then, that is to foreclose and try to collect your loans or else try to get a sale or a merger, anything to—even a salvage position.

Q. Have you experienced a situation where you had to go
to salvage and get what you could out of a loan?

41 A. Yes, sir.

Q. When you had to go into one of these salvage operations, I would assume that the bank looks to the collateral security pledged for the loan. Is that right?

A. Yes.

Q. As a policy matter in making the loan to borrowers, what security does the Bank require?

A. Our policy is to get all the security we can get, and we would like to have our loans fully secured.

Q. Do you have any policy as to minimum security requirements, and if so what are they or what were they during the years in question here, 1961, '62 and '63?

A. On term loans, facility loans, we have to get a first mortgage security on the property. On operating loans—they may be secured by various assets or unsecured.

Q. I believe there are three types of loans which the Banks or Cooperatives makes, is that right?

A. At that time we had three types.

Q. What were those three types?

42 A. Commodity loans.

Q. What does that mean, a commodity loan, what is the borrower borrowing the money for?

A. He is borrowing the money for a short period of time to finance, for example, a bale of cotton in a warehouse, or soy beans in storage, in an elevator, or fertilizer inventory in a warehouse, all of those products would be eligible for a commodity loan, but the loan would be made and the commodity would secure the loan. There may be some other security in addition to that, but primarily the commodity.

Q. Would the commodity itself be the minimum security requirement?

A. Yes, sir. Then we had the operating loans, and these operating loans would be secured by inventories, accounts receivable, factors lien on inventories or there may be an operating loss loan which may be unsecured depending on the financial strength and the balance sheet of the borrower. Facility loans, we covered those previously.

43 Q. A facility loan, as I understand it, if an individual wanted to expand a plant, he could get a facility loan and the building itself would be security for the loan. Is that basically correct?

A. The land and building or buildings and what you would call the machinery and equipment that would be of a fixed nature, not movable.

Q. I understand. It is my understanding that Mississippi Chemical Corporation and Coastal Chemical Corporation borrowed money from this Bank during 1961, '62, and '63?

A. Yes, sir.

Q. Would the amounts of money that these corporations borrowed from the Bank in those years fall into one of the three categories, and if so which one?

A. It would fall into two categories.

Q. Which are they?

A. Facility and operating.

Q. Were the operating loans obtained by those two corporations secured or unsecured?

A. Secured.

Q. What about the facility loans?

A. Secured also.

44 Q. What type of security was pledged for the loan or given for the loan, the facility I assume would be—

A. ~~The~~ properties.

Q. It would fall under the term that you just explained?

A. Yes.

Q. Has this Bank ever accepted collateral for a loan of any sort Class C stock owned by the borrower?

A. As collateral for a loan?

Q. Yes.

A. No.

Q. Now, you have stated that there have been occasions when the Bank was unable to—

A. We have a lien on the stock, though, is that what you mean?

Q. No.

A. When we make a loan, if the borrower owns C stock, we have an automatic lien on that stock.

Q. A statutory lien on that stock, do you not?

A. Yes, sir.

Q. But the question on that particular point was has the Bank ever collateralized a loan on the basis of Class C stock alone?

A. No.

45 Q. Now, you stated that the Bank has run into loss situations on occasions.

A. Yes, sir.

Q. What it did, I assume, it did what it could to recover or minimize the losses?

A. Yes, sir.

Q. In doing that, has the Bank ever gone against Class C stock that was pledged as collateral for the loan?

A. Yes, sir; we have offset.

Q. You have stated that the Bank has gone against Class C stock pledged as security for loan?

A. Yes.

Q. You have also stated, I believe, that the Bank has not made loans on the basis of Class C stock alone.

A. That is correct.

Q. So it would appear that the Bank has had an election to go against Class C stock or other security?

A. Yes.

Q. Has it had that election in those situations?

A. Just in the case of default.

Q. Now, in those cases of default, what security did
46 the Bank in fact go against first?

A. The prime security behind the loan.

Q. But you say it has gone against—

A. You said first.

Q. Yes, I understand.

A. We always go to the prime security first.

Q. But you say it has also gone against the Class C stock?

A. When the amounts collected and applied against the loan were not sufficient to liquidate it fully.

Q. In the case where you did go against the Class C stock, to what extent did you credit the borrower with the Class C stock which you went against?

A. Dollar for dollar.

Q. Describe the record or records of the Bank that would reflect the handling of a defaulting borrower.

(Discussion off the record.)

The WITNESS: It would have to be the stock record of the Bank.

By Mr. WARREN:

Q. Would any stock records of the bank indicate that
47 the borrower, the defaulting borrower's credit had been reversed out for the purpose of applying that credit to his loan?

A. Yes.

Q. You said earlier that the Bank has not physically delivered to borrowers Class C stock purchase as a condition to making a loan initially or purchased as a "interest override"

or as patronage dividends. What evidence of stock ownership did the Bank provide the borrower with, when did it provide the borrower with that evidence?

A. We provided it with notification each year by letter of their ownership status or investment status.

Q. In Class C stock?

A. In Class C stock.

Q. Did I understand you also to say that the Bank had not issued a certificate of Class C stock to indicate that the borrower had met his initial eligibility requirement?

A. That is correct.

Q. Why didn't the Bank issue actual certificates of Class C stock, Mr. Verlander?

48 A. Because our Board has never adopted a form of certificate and it's not required.

Q. How do the interest rate charge borrowers the New Orleans Bank for Cooperatives compare with commercial rates of interest?

A. I would say comparable.

Q. How then does the New Orleans Bank for Cooperatives compete with commercial banks in lending money?

A. Through other services that we offer in the field of management, advice and counsel and financial management.

Q. Do you mean by that that you have a staff of or some individuals at least who go into the field to aid and assist borrowers in setting up their financial matters?

A. Yes, attend their Board meetings when requested, advise with them when requested.

Q. Does the Bank render advice to its borrowers on the question of mergers and consolidations?

A. Yes, and in a few cases we had in this district.

Q. And do they also advise the borrower of the feasibility of plans to expand the borrowers business?

A. Yes.

49 Q. Now, does the Bank give advice to cooperatives as to how they may efficiently meet competition in their businesses?

A. Yes, I would say that, in those cases where they were qualified.

Q. Has there been a borrower of this Bank which liquidated or dissolved during the period when that borrower owned Class C stock of this Bank?

A. Yes.

Q. When a particular borrower liquidated or dissolved, how did the Bank handle the retirement if it did retire of that borrower's Class C stock?

A. We have not retired any C stock except by offset against defaulting borrowers.

Q. Has the District Board made a policy determination as to what it would do or what should be done in those situations where you have a borrower to liquidate or dissolve?

A. It has taken the position not to retire Class C stock, except they want to review each case and see how it stands. Of course, the manual gives us leeway on this, but our Board has taken a stand that it wants to look at each individual situation.

Q. And in those situations where the problem has been presented to the Board, the Board has decided against it?

A. As a matter of policy, yes.

Q. Decided against retiring the Class C stock of the dissolved or liquidated borrower?

A. Yes.

Q. Is that policy reflected in the minutes of the Board?

A. In each case that is presented.

Q. The Board made a decision as to whether it would credit or pay the—

A. You didn't ask, you didn't ask about the automatic as the offset.

Q. When a borrower liquidates or dissolves, the Board has never seen fit to retire that dissolved or liquidated borrower's Class C stock. Is that correct?

A. That is right.

Mr. SATTERFIELD. You are talking about where there is no default, are you not?

Mr. WARREN. Not necessarily.

51 By Mr. WARREN:

Q. I believe the answer is the New Orleans Bank for Cooperatives has never retired Class C stock except perhaps in the case where there has been a defaulting borrower.

A. Yes.

Q. So far as you know, what are the factors that are to be taken into consideration in determining the extent to which the Bank will retire Class A stock?

A. The factors, the factors that determine the amount we will retire each year?

Q. Yes.

A. Earnings, the amount of stock that is purchased by co-operatives during the year, whether or not if we had an impairment of capital that would throw us off schedule, and I might add that we haven't had that up to now, and the amount of losses. As I say, if you had a large loss that is sustained, it would affect it.

Q. Would the amount of franchise tax required to be paid to the Federal Government be of a factor?

A. Yes.

10 TRANSCRIPT OF TESTIMONY TAKEN NOVEMBER 7, 1968

May it please the Court, we now call Mr. Walter C.

11 Verlander, Jr., President of the New Orleans Bank for Cooperatives, as a witness for the Plaintiff.

Walter C. Verlander, Jr., Called as a witness for and on behalf of Plaintiff, was sworn and testified as follows:

DIRECT EXAMINATION

By Mr. SATTERFIELD:

Q. One question only; for how many years have you been with the New Orleans Bank for Cooperatives?

A. 22 years.

Q. Mr. Verlander, there has been introduced an extensive stipulation in this matter; I would like to ask you some questions which are pertinent to the issues herein formed and in relation, generally, to the stipulation. Mr. Verlander, this matter uh chiefly involves the question of what is referred to as Class C Stock in the New Orleans Bank for Cooperatives. It particularly involves the question of the fair
12 market value thereof. I will ask you whether at any time, to your knowledge, the New Orleans Bank for Cooperatives has sold it's C Stock to a purchaser other than in connection with or as a part of the so-called investment over-ride related to the interest paid by a borrower from the bank, or in relation to patronage refunds declared by the New Orleans Bank for Cooperatives?

A. No, it hasn't.

Q. Uh has the uh bank, and I refer to it simply as the bank, to your knowledge ever actually issued any certificates of Class C stock?

A. No, the bank hasn't issued any certificates.

Q. Now it is, uh in connection with loans by the bank to it's borrowers, would you state whether or not the bank gives any collateral value to the Class C. Stock which has been uh declared to such borrower, or which has been entered in your records in connection with the so-called interest over-ride?

A. No, we give no collateral value to the stock.

Q. Then in connection with the security required to obtain a loan that is other certificate other than such stock, is it not?

A. Yes sir, we take other security.

Q. However, in connection with such loans and as a
13 part thereof, does the bank uh maintain a first lien upon such C stock uh declared by the bank to the borrower?

A. Yes, we have a statutory lien on the stock.

Q. To your knowledge, at any time has the bank released such lien to uh from, has the bank released such lien while there was outstanding an indebtedness from such borrower to the bank?

A. No.

Q. Now in the organization of the bank and it's by-laws, are there any provisions for stockholder's meetings to be held?

A. We have no provision for, in the by-laws for stockholder's meetings.

Q. Do you occasionally have——

A. We do have meetings though uh with uh our borrowers. We call them annual stockholder's meetings but it's merely reporting on the activities of the bank.

By Mr. WARREN:

14 Q. Then these, these meetings annually with your stockholders in the several states are for the purpose of reporting and information, are they not?

A. We report information on the bank to the stockholders.

20 Q. Now what interest spread is involved, or was involved in uh arriving at what is already in evidence, the contemplated or proposed basis of retainment of the Class

A Stock held by the Government? What generally, what size spread was that referred to, or related to?

A. Currently, or do you mean—

Q. Generally, just just give the Court a picture over a period of years?

A. Well at the time uh uh when we began retiring this Government capital in 1956 and we set up a program for retirement of the Government capital over a period of twenty years, we contemplated at that time a spread of about 1%.

21 Q. That's called a hundred points or 1%?

A. That would be a hundred points uh in market terminology.

Q. Has that been reduced or increased? What is the present situation then as it developed over the years?

A. Due to, it has shrunk quite a bit over the course of the years.

Q. To what uh spread has it shrunk? How many points difference is that at the present time?

A. Last month it was 22 points.

Q. Is that—

A. That's less than one-quarter.

By Mr. WARREN:

24 Q. Now Mr. Verlander, the evidence shows there is a statutory requirement for the retirement of Class uh A Stock held by the Federal Government. Has the New Orleans Bank for Cooperatives ever retired any Class C Stock other than in connection with liquidations, bankruptcies and so forth?

A. In the case of uh a borrower who's indebtedness is in default, we would apply it against that indebtedness if the primary security was not sufficient to cover uh the indebtedness.

Q. And other than in such type of liquidations, have you ever retired Class C Stock and paid it uh off at par?

A. No.

28 By Mr. SATTERFIELD:

Q. When the, the Class A Stock held by the Federal Government is uh retired, what effect, if any, would the requirement, would the removal of the exemptions of the bank from the payment of Federal Income Taxes, Franchise Taxes,

29 State Taxes and other taxes have upon the rate and extent of retirement of Class C Stock?

A. It would have an effect on the uh time span of redeeming this Class C Stock.

Q. And what would be that effect with reference to prolonging it or otherwise—

A. It would prolong it to some extent but I couldn't peg it down to any definite year.

Q. In fact, it would be impossible to determine the exact effect—

Q. Are you able, at this time, to determine the exact effect of the imposition of such taxes?

A. No, because we don't know the extent of our State uh Taxes.

Q. I see, thank you. Now Mr. Verlander, there has been into the record, the various facts concerning the restrictions upon Class C Stock, it's use, it's transfer, etc., which we will not review, it's already in the record. Uh in your opinion, does the Class C Stock of the New Orleans Bank for Cooperatives have a fair market value—

31 By The WITNESS:

In my opinion, it has no fair market value.

By Mr. SATTERFIELD:

32 By Mr. SATTERFIELD:

Q. Now Mr. Verlander, in connection with the use as related to the value, certainly the question is as to the use of Class C Stock. In relation to the interest over-ride of the payment of 15% of the amount of interest payable by a borrower on a quarterly basis, does the New Orleans Bank for Cooperatives permit Class C Stock to be purchased by one cooperative from another cooperative and then used in lieu of paying cash to the bank for the interest over-ride?

A. Uh no, we have not had that occasion.

Q. Have you ever permitted that to be done?

A. No.

Q. Do you permit a borrower who has accumulated C Stock on your books through borrowing in previous years, to use any portion of that C Stock as uh payment of the interest over-

ride in lieu of cash? Where one borrower has accumulated C Stock on your books in former years, do you permit that borrower to use that C Stock to pay the interest over-ride or do you require it to be paid in cash?

33 A. Require the borrower to pay it in cash.

CROSS EXAMINATION

By Mr. WARREN:

Q. Mr. Verlander, in your opinion is the stock referred to as interest over-ride stock or C Stock?

A. No answer.

Q. Capital stock of the New Orleans Bank for Cooperatives?

A. Yes.

Q. You have stated on direct examination that no collateral value was given to uh C Stock owned by borrower from the bank, is that correct?

A. That's correct.

By the COURT:

Let me ask him this question——

By the WITNESS:

We have given it no value. When the, a borrower comes into the bank to borrow, applies for a loan, we examine it's credit base and we give no collateral value to C Stock.

34

By Mr. WARREN:

Q. Mr. Verlander——

By the COURT:

You stated that you didn't think that the C Stock of this bank had any market value——

By the WITNESS:

Any fair market value.

By the COURT:

Would you say that it had any value?

By the WITNESS:

I, I would say yes.

By the COURT:

You wouldn't say it was worthless, would you?

By the WITNESS:

I would say it has a market, I mean a value.

By the COURT:

But not a market value in that's it's not traded——

By the WITNESS:

That's right.

By the COURT:

But you would say that it had a fair value, wouldn't you?

By the WITNESS:

I would say that it has value, it has worth.

35

By the COURT:

What would you say is the worth of one share?

By the WITNESS:

I would have no way of determining the worth.

By the COURT:

Just because you haven't seen it traded?

By the WITNESS:

If I were a cooperative, I don't know how I could arrive at that.

By the COURT:

Well of course, value is not determined by what it's worth to the owner. I'm talking about what it may be worth to somebody else who needs it real badly but it's value is what amount of money could be realized from sale of a property by someone who had it and was willing to sell it but didn't have to sell it to some one who was willing to buy it but didn't have to have it.

By the WITNESS:

That would be my understanding of the fair market value. Where a willing seller and a willing buyer who would pay (inaudible).

By the COURT:

Well that would be value as well as market value, wouldn't it?

36

By the WITNESS:

But I, I don't know what anyone would uh be willing to pay since it's not traded uh in any way. It has limitations. It has, it's value is always with relation to the bank par, and we set it up on the books at a hundred dollars per share and uh it will always be worth par when redeemed, or if redeemed.

By the COURT:

But would that stop in and of itself doing anything for an owner, either in returns, or advantages, or benefits, or facilities of any kind?

By the WITNESS:

Uh it's a requirement for the borrower to obtain a loan and it's in the statute.

By the COURT:

Sort of like having a membership in the country club. Then you couldn't go to the club unless you had some of this stock as membership. That's what that is, isn't it?

By the WITNESS:

In, in a sense, that's right.

By the COURT:

40

Q. But at the time, at the time that you, you established uh the pay out period, could you say that you had had twenty years experience, or fifteen years experience over which to make a judgment with respect to this 1% spread?

A. Yes, we have experience in the operation of the
41 bank.

Q. That's been operating since 1933—

A. 1933, yes.

Q. You've been dealing in the money market almost daily since that time?

A. Not daily but uh we've been dealing in the money market, yes.

Q. Now is it true that uh after stating, after setting up the pay out period and setting up the amount that you could pay out each year to meet that uh retirement goal, that you did even better than you had expected, that is, that you paid off, that you exceeded your retirement goal in each year after setting it up?

A. Yes, we did, due to increased loan volume.

Q. When you set up the goal, could you anticipate increased loan volume?

A. We took that under consideration in our, in our original estimate to set up a goal because you will notice that the C Stock retirement; uh that we projected increased periodically through the period.

Q. On direct examination, you stated that C Stock was never retired by the bank except in a situation where you were dealing with with the C Stock of a defaulting borrower, is that correct?

A. Yes.

41 Q. And uh you applied his C Stock to the payment of his debt?

A. To whatever portion that would be needed to satisfy him.

Q. Now did you apply that, that is, if he had a hundred dollars par value, one share of stock, C Stock with a par value of one hundred dollars and he owed the bank two hundred dollars, after the application of his stock what would he then be left owing the bank under that example?

A. If uh, you say if the security did not liquidate the loan—

Q. Yes sir.

A. And we had to apply the value of the, we had to apply C Stock, we took that option to apply C Stock—

Q. Yes sir.

A. We would uh push it in there at the full value, par value.

Q. In other words, you would apply it on a dollar for dollar basis?

A. On, at the par value, yes sir...

Q. Now as I understood your answer a while ago, your answer was restricted to C Stock only. Isn't it also true that you would apply allocated surplus to that defaulting borrower to his uh debt also?

A. If it would be required.

42 Q. Uh—

A. To uh liquidate the indebtedness.

Q. And you would also apply the allocated surplus on a dollar for dollar basis—

A. Yes sir.

Q. Par value of the allocated surplus.

A. Yes sir.

Q. Now you were asked some questions about uh a tax uh on cross examination and you said that, as I recall, that after the A Stock was fully retired that your tax base will change, is—

A. That's correct.

Q. That correct?

A. That's correct.

Q. Now when you say that your tax base will change, what do you mean by that, Mr. Verlander?

A. We become, we will be in the same position as a uh a cooperative that does not have an exemption.

Q. What sort of income, does the New Orleans Bank for Cooperatives have income from a tax sense?

A. Yes, that would be tax.

Q. What is the source of that income?

A. That would be interest on uh Government securities that we own and uh possibly some interest uh that uh would be realized in a bank from uh investment of our funds in
43 the daily operation of the bank.

Q. Would this, would this be a substantial tax, Mr. Verlander? You're talking about tax on interest on money, aren't you?

A. Yes. This would be on interest income not uh from the patrons of the bank but uh business uh——

Q. Essentially invested money of the bank——

A. Yes.

Q. That was invested?

A. Yes. Of course, we, going one step further, any other income too would be uh you would call it income from uh operations other than or from assets other than in our lending operations would be taxable.

Q. Can you give me for an example?

A. Well for example, if we ever had rental income, we would have to pay tax on that, Or extraneous income.

Q. That's what I'm getting at. What extraneous income do you anticipate that the bank might receive in the future years?

A. Well we don't have any other than this investment income.

Q. Now I believe you stated that uh borrowers were
44 required to pay for C Stock in cash, that is, the so-called interest over-ride for this investment stock. Is it not so that, well, isn't it true that B Stock could be converted to meet the investment requirement?

A. Absolutely, if the borrower owned B Stock he would have that privilege to convert it.

Q. Now will that be, did that occur?

A. In many cases, yes sir.

Q. And when it occurred, uh well, strike that. What was the par value of the B Stock?

A. A hundred dollars per share.

Q. And the same was true, the C Stock had the same par value?

A. Yes.

Q. When uh B Stock was exchanged for C Stock for these investment requirements, was one share of C Stock uh given to the uh borrower for one share of B Stock?

A. Yes, and the reason, because the borrower paid cash for B Stock and uh since it was paid uh in, for in cash, why uh it would be the same thing as buying a share of C Stock and converting it.

Q. Yes sir. Uh but it's also true that there is a pertinent to a share of B. Stock a right to dividend?

A. Yes, —

Q. Isn't that true?

45 A. A small dividend (inaudible) two, four for seven.

Q. And uh there is no dividend rights pertinent to C Stock, is that right?

A. That's correct.

Q. Now let me ask you in this area here. While while there's no dividend right to uh C Stock, did the bank consider allocated surplus as being a pertinent to C Stock? In other words, if if uh an individual, if two borrowers wanted to transfer C Stock, is it not true that as a matter of course the allocated surplus relating to that C Stock is transferred at the same time? Do I make myself clear to you?

A. Uh yes, uh I think you do. And I would say in cases yes, the allocated surplus was also —

Q. But the allocated surplus goes right along uh hand in glove with the C Stock?

A. Generally, but as far as it's uh status, it's not C Stock because it is just a credit on the books and it would be behind C Stock.

Q. It's a credit on the books —

A. Of the Bank, credits on the books of the bank in the in the borrower's uh —

Q. In lay terms, in lay terms, I hope you understand what I mean, uhh could we say that uh when you credit these uh
46 sh shares of C Stock on the books and the allocated surplus on the books, that is, at the bank, that this allocated surplus and C Stock was owned by the borrower, I'm talking about lay terms?

A. Yes.

Q. As I understand it, the bank also had uh in addition to it's allocated surplus, another type of uh reserve. Well, first of all,

let me ask you, isn't it true that the allocated surplus was some sort of reserve for the bank?

A. Well it's a mandatory reserve uh that's required in a loan.

Q. How is the amount of the al uh funds that go into the allocated surplus measured?

By Mr. SATTERFIELD:

Please the Court, I have an objection to the last some fifteen or twenty questions. They are all covered by the stipulation, the relationship of allocated uh surplus being subject to the C Stock and subject to use by the New Orleans Bank for Cooperatives if necessary; the various provisions are shown in the stipulation. I object on that ground.

By the COURT:

What's the need in going over it again, Counsel?

By Mr. WARREN:

I, I, I, it may be in there but at the present time,
47 I don't recall where it would be, Your Honor.

By the COURT:

Well I'll let you ask him if you're not sure.

By Mr. WARREN:

Yes, sir.

Q. Uh the question is how is the amount of the allocated surplus arrived at? How do you determine, after you've got earning, earnings and you're going to uh credit some of the earnings to uh allocated surplus of the borrower and some of it to the borrower as C Stock patronage refund. How do you measure the amount that you are going to allocate to allocated surplus and to Class C Stock?

A. In the operations of the bank, of course, we have to operate under the law and the law spells it out how the earnings of the bank will be uh allocated at the end of the fiscal year. Uh the first take out is for any impediment on uh stock. Secondly, 25% of the earnings uh is set up in this allocated reserve, or allocated surplus, as you call it.

Q. All right, sir. That's as far as you need to go unless you want to go further.

A. No.

Q. Okay. Uh you say you first restore any impairment of capital?

48 A. Yes sir.

Q. And it's been stipulated that the New Orleans Bank for Cooperatives has never had any capital impaired, at least the Board has never made any such determination?

A. True.

Q. What, what, the bank sort of hangs on to this uh allocated surplus, in lay terminology, and what does it hang on to it for? If you know.

A. For reserve, for uh any losses that might uh uh come up.

Q. Yes sir, but uhh there is another type of surplus the bank has, isn't it, doesn't it, Mr. Verlander?

A. We have no contingency reserves, no.

By Mr. WARREN:

May I get one of these documents here? Just want to clarify a point or two.

Q. Look at page 109 of uh, let me see the exhibit number on that, Mr. Verlander, so I can make a record reference. I have handed you stipulation exhibit number 19-f and I ask you to look at page 109.

A. Yes sir.

Q. Of that uh exhibit, that's the operating statements of the balance sheet of uh the New Orleans Bank for Cooperatives on the right hand side, isn't it Mr. Verlander?

A. Yes sir.

Q. Now down at the bottom, we've got two kinds of surpluses, do we not?

A. Yes.

Q. Well will you tell the Court what that first uh what that first reserve is for?

A. The first surplus?

Q. Yes sir.

A. Three million six hundred and twenty seven thousand?

Q. Yes sir.

A. That represents the earnings of the bank that uh were accumulated from 1933 until January 1, 1956.

Q. For what purpose?

A. That uh set out there as surplus.

Q. What the particular point is, would it be fair to call this a valuation reserve?

A. No sir.

Q. Where is the valuation reserve of the bank on that balance sheet?

A. We have no valuation reserve. We have uh a reserve for losses or uh loans and this is uh in the asset side.

Q. In in case the uh bank were to get into some financial difficulty and you haven't uh priority, don't you, 50 what uh what accounts you reduce first?

A. Yes sir.

Q. In In the uh order of priorities, where would you get to uh reducing the amount of allocated surplus that is, surplus allocated to—

A. If we had a loss?

Q. Yes sir.

A. On our loans?

Q. Yes sir.

A. We would first apply the reserve we have for losses on loans, and if that reserve was not sufficient uh to uh satisfy it, we would go to our earnings for that year and apply those. And if that was not sufficient, then we would go to the surplus allocated to patrons.

Q. All right, sir. Now the next next point is uh during your entire tenure with the New Orleans Bank for Cooperatives, has it ever been necessary to uh reduce the amount of allocated surplus by virtue of a loss sustained by the bank?

A. No.

Q. Mr. Verlander, I don't know whether I asked you 51 this, but if I haven't and to be sure I have it in the record, let me ask you uh if I used the term, old stock, old stock—

A. Ode stock?

Q. Old, O L D, stock, would you know what I meant?

A. Yes.

Q. What, what does that mean?

A. Uh this uh before the 1955 amendment uh went into effect. In other words, from a period, 1933 through uh 55, the bank issued this uh stock to a borrower in proportion to the amount of loan that a borrower requested or applied for.

Q. Now comes the Farm Credit Act of 1955. Uh there was no more of that old stock, so-called, issued, was there?

52 A. That's correct.

Q. Now did the bank permit uh holders of that old stock to exchange it for C Stock under the 1955 Act, to meet the investment requirements with respect to uh C Stock purchases uh related to loans?

A. I uh my memory is vague on that as of now.

By Mr. WARREN:

May the witness have exhibit number 13-a?

Q. And page 4, page 4 of 13, exhibit 13-a, under the section referred to as deductions, do you see a provision that says quote old unquote stock (inaudible) is that a requirement?

A. Yes.

Q. Do you know what that means?

A. Yes.

Q. What does it mean, please sir?

A. It means that the old stock that a borrower had was converted C Stock.

Q. I don't mean to be uh I can appreciate the fact that you couldn't understand that, I mean you didn't know the response to my question before, but having looked at this which you recognize I would think as a report to the Board of Directors of the Bank of uh 1960—

A. Yes.

53 Q. Do you recall whether that old stock was converted on the basis of uh dollar for dollar?

A. Yes, because the borrower actually paid cash for it, in a sense.

Q. What do you mean by in a sense?

A. Well it was either added to or deducted from the loan.

Q. That is when he acquired the old stock?

A. Yes.

Q. Did the New Orleans Bank for Cooperatives permit holders of old stock to have that uh old stock redeemed for cash or applied to uh their indebtedness?

56

Q. Yes sir, Uh did the New Orleans Bank for Cooperatives permit the owners of old stock to redeem that old stock for cash once they paid off the loan?

A. No, we didn't redeem it for cash. We just applied it against the remaining loan balance.

Q. All right, sir, that's all right—

57

A. In other words, we didn't give the man cash for it.

Q. If he had a hundred dollars worth of old stock and uh par value of one hundred dollars and he owed the bank, a hundred dollars would just wash the thing clean and that's it?

A. Yes.

Q. Okay. And did, did this occur after the effective date of the Farm Credit Act of 1955?

A. If a borrower had a loan contract with the bank, say a term loan, it would, of course, have been made, say before the effective date of the Farm Credit Act uh as amended uh in 1955 and uh since that contract was outstanding, well we had to abide by the terms of that contract.

[60]

Q. uh Do you know where the term, interest over-ride, came from, Mr. Verlander?

A. The origin of that phrase?

Q. Yes sir. Do you know where it came from?

A. We coined it in the bank (laugh) and our borrowers, I think, picked it up also.

Q. Does, does the phrase mean to you, of being the President of the bank, uh something other than interest?

A. It means the amount uh that we require our borrowers uh to pay over and above the C Stock for the purchase
[61] uh over and above interest for the purchase of G Stock.

Q. All right, sir.

By Mr. WARREN:

Your witness.

REDIRECT EXAMINATION

By Mr. SATTERFIELD:

Q. Mr. Verlander, when you referred to the amount required to be paid over and above the interest for the C Stock, when you use the word interest, you were referring, were you not, to the interest set forth in the loan documents as to which there was an agreement to pay this additional amount. Isn't that correct?

A. Yes sir.

Q. And in uh Exhibit No. 2 to the uh Coastal stipulation and Exhibit 31 to the Mississippi Chemical Stipulation, you might refer to Exhibit 2 you have there before you there, they're the same in both, the uh other than the first entry of the quali-

fying share, the entries are in the number of dollars rather than the number of shares, are they not?

A. Yes sir.

Q. And that is true all through your ledger showing these amounts, is it not?

62 A. Yes sir, that's correct.

Q. Now awhile ago, Counsel asked you about the order in which you would resort to the various items appearing in your financial statement in case there was a loss but interpose when you had gotten to the point of allocated surplus. You stated that you first resort to the reserve for losses, then resort to earnings for that year, then to allocated surplus thereafter. Then what would you resort to as a fourth source of funds to take care of any losses after you had exhausted the allocated surplus?

A. Go to the C Stock.

By Mr. WARREN:

I would object to that. The witness testified that they uh never had any occasion to go against uh allocated surplus and that's a step beyond allocated surplus.

By Mr. SATTERFIELD:

Please the Court, the witness has stated that up to this point they have had not go to the allocated surplus but when this witness got that far, Counsel interposed and did not let him finish (inaudible).

By the COURT:

You asked him what he would do, I'll overrule the objection.

63 By the WITNESS:

We would go to the C Stock.

By Mr. SATTERFIELD:

Q. Now there was some questions about the old stock. I won't belabor the questions other than there's one explanatory question, this matter of the use of the old stock, that was not a matter of exchange of stock for stock; the use of the old stock rather than use of new stock, was it not?

A. Correct.

Q. Now during the period here involved, was your bank limited in the amount of interest which it might charge up until recently?

A. Yes, we had a ceiling.

Q. And——

A. On the interest rate we could charge our borrowers.

Q. And what was that?

A. 6%.

Q. Now there was the question asked on direct examination to which objection was made uh concerning the retiring of the government A Stock and the spread which you expected to be utilized in connection therewith, which question had to do with the experience thereafter existing now and which will affect, in fact, the present existing C Stock. Counsel
64 asked you on the cross as to whether when you set up the goal or expected planned retirement you had twenty years experience or more in the banking business. Since that time you have also had further actual experience, have you not, in the banking business?

A. That's right.

Q. Have you had actual experience in connection with the spread to which you referred before?

A. It has declined.

Q. Now in relation to the spread which would be required in order to retire the A Stock as originally planned, uh what spread in your present volume of uh loans would be required?

A. We feel that it would take about a fifty point spread which would be one half of one percent between the average cost of our borrow funds and the cost we charge.

Q. Is that your best judgment?

A. That's my best judgment.

Q. And what spread are you now able to obtain and are obtaining?

By Mr. WARREN:

I object, Your Honor——[inaudible.]

By Mr. SATTERFIELD:

May it please the Court——[inaudible.]

65 By the COURT:

Let him finish his objection, I haven't heard it yet. You all had better start all over again, both of you were talking at one time.

By Mr. SATTERFIELD:

The question was you have made the statement concerning your expectations or experience in the past. What has been

your actual experience in recent years with reference to the spread which is required to carry out the schedule, in your judgment, of the spread which you are now able and are obtaining in relation to that retirement?

By the COURT:

All right.

By Mr. WARREN:

Now it is true, of course, that I did ask Mr. Verlander concerning his experience uh prior to 19 prior to the time that the goal was established.

[66]

By Mr. SATTERFIELD:

Q. Questions were asked concerning the uh type of taxation to which you would become subject when the Class A Government Stocks were retired, those questions of Counsel being limited to income tax. Are there any other types of taxation to which you would then become subject and which would effect the matters here involved?

67 A. Franchise taxes and state's.

Q. And property tax?—

A. That would—

Q. Are property taxes involved?

A. Property tax?

Q. Yes, property owned by—

A. We have uh, we don't own the building, we just rent space.

Q. Certain questions were asked with reference to Exhibit 5—a being the form of a note and uh a certain printer portion thereof. Uh was that in relation to your testimony that a lien existed against such stock regardless of the fact that no collateral value was given? Referred to a lien existing as against interest?

A. Yes.

By The COURT:

Would the amount that these Plaintiffs in this case paid for the C Stock plus the amount of the interest in these tax years exceed six percent?

By The WITNESS:

Pardon me, Your Honor?

By The COURT:

You said these borrowers had to own some C stock—

By The WITNESS:

68 Yes.

By the COURT:

And had to pay a hundred dollars a share for the stock and had to pay other amounts periodically. What I'm trying to find out is do you know whether or not either one of these Plaintiff's or borrowers for any one of the tax years in question paid more than six percent when you take into consideration the amount of money they paid for the C Stock plus the amount of money which you are calling interest?

By the WITNESS:

I would uh believe that uh at that time rates were not high enough for the total of the two uh the interest charge plus the over-ride, I don't think it would exceed six percent.

By the COURT:

That's what I was interested in——

By the WITNESS:

At at the time that these loans were——

By the COURT:

That's what I'm talking about, because it seems to me as a matter of law that if you charged a concern, say 5% and then you charged him a cent and a half to entitle him to approach you on the subject of making a loan that for all intents and purposes you would have charged him six and a half percent instead of six.

69

By Mr. SATTERFIELD:

May it please the Court, I believe this is fifteen percent of the interest rather than fifteen percent upon the principle.

By the WITNESS:

Correct.

By Mr. SATTERFIELD:

It's fifteen percent of the interest charged as distinguished from one point five percent of the principle.

By the COURT:

That wasn't what I was talking about. He said he couldn't charge more than six percent. Well he was charging an amount which he was calling interest——

By the WITNESS:

No sir——

By the COURT:

That——

By the WITNESS:

We did not call it interest. We call it an investment in the bank.

By the COURT:

70 Well I wasn't talking about C Stock right now. I'm talking about what you call interest because you did get interest, didn't you?

By the WITNESS:

Yes sir.

By the COURT:

When you lent them some money?

By the WITNESS:

It was below the six percent rate at that time.

By the COURT:

But my question was whether or not this amount which they had to pay for the C Stock plus the assessments on the C Stock plus what you charged them and called it interest would exceed six percent.

By the WITNESS:

Uh.

By the COURT:

You follow that?

By the WITNESS:

No, uh I really don't uh Your Honor, because we have only an interest charge in our loan contract; also in our loan contract at that particular time, we had a provision that the borrower would pay on the uh interest that he would pay to the bank uh fifteen percent an additional fifteen percent of that interest and he would receive C Stock in the bank for that payment.

71

By the COURT:

That's what I understood. That's the reason——

By the WITNESS:

And uh say if you have uh a four percent rate, let's assume a four percent interest rate, straight interest rate at the time, then the fifteen percent would amount to uh sixty points. So the effect, if you were looking at it as an effective cash cost to you, as a borrower, it would have been four point six zero.

By the COURT:

I see. So it still wouldn't have exceeded six percent?

By the WITNESS:

That's correct.

By Mr. SATTERFIELD:

If the Court will indulge me just one moment, I would like to confer with Counsel.

By the COURT:

All right.

By the WITNESS:

And this is the way borrowers have looked at it. Uh they look at the cash that pulls out the uh interest rate and this C Stock investment.

By the COURT:

72° That's what I'm looking at. I don't think it makes any difference what you call it if you charged that for it, I think in law and certainly in usury cases it would be interest.

By Mr. WARREN:

I would like to offer something against that at the proper time, Your Honor.

By Mr. SATTERFIELD:

We have one more question, may it please the Court.

By the COURT:

All right.

By Mr. SATTERFIELD:

Q. Question was asked concerning about whether when a when a share, shares of C Stock were acquired, sort of like joining the country club, I believe question of that effect. Uh is it not a fact that when a cooperative buys one share, qualifying share, of stock, thereby he becomes eligible to obtain a loan if he has proper security?

A. That's right.

Q. And once having thus qualified, thereafter is a question of security and business, is it not? Proper security and proper banking business?

A. That's correct.

Q. Thank you.

73 By Mr. SATTERFIELD:

Call Mr. MOUNGER, please.

WILLIAM M. MOUNGER called as a witness for and on behalf of Plaintiff, was sworn and testified as follows:

By The COURT:

We'll take a ten minute recess.

(Court recessed at 4:40 P.M. for 10 minutes).

DIRECT EXAMINATION

By Mr. SATTERFIELD:

Q. I believe you have been sworn, have you not?

A. Yes, sir.

Q. What is your name, please sir?

A. William H. Mounger.

Q. And, Mr. Mounger, what is your business or profession?

A. Investment banking and brokerage.

Q. And with uh what firm are you now connected?

A. Leland Speed-Mounger & Company.

Q. And where is that located?

A. Jackson, Mississippi.

Q. For what period of years have you been uh engaged in business or professional activities related to the purchase and sale of stocks and bonds?

A. Roughly 29 years with just a few years out for service in the F.B.I. Except for that, uh altogether in this field.

Q. I see. Would you give us some of the connections and capacities in which you uh served in that connection?

A. Well I started in the bond-investment department of Union Planter's National Bank in Memphis; became vice-president of Equitable Securities Corporation which is in the general investment banking business; was president, executive vice president of Lamar Life and on their investment committee—

Q. Is that the Lamar Life Insurance—

A. Jackson.—

Q. Company, Jackson, Mississippi?—

A. And on the board and—

By The COURT:

John he can't get you when you butt in on him like that. He couldn't take either one of you.

By the WITNESS:

On the board of the executive committee of the First National Bank, pertaining somewhat to investments; and then in business at Leland Speed-Mounger & Company.

75 By Mr. SATTERFIELD:

Q. When you refer to the First National Bank, are you referring to the First National Bank in Jackson, Mississippi?

A. Yes.

Q. Have you served on the investment committee of any insurance company other than the Lamar Life Insurance Company in Jackson?

A. Consolidated American Life Insurance Company of Jackson investment committee and of the University of Mississippi. And I believe Millsaps College, Jackson.

Q. Have you, during uh experience that you have accounted, become familiar with the elements entering into the determination of the fair market value of stocks, bonds, and other securities?

A. I believe that I have.

Q. We have here involved a question of what is sometime referred to as fair market value, sometimes referred to as what a willing buyer would pay to a willing seller for a security, neither being under compulsion and I'll ask if you will state state briefly to the Court some of the major elements that enter into a determination of uh such a factor?

A. Well return, of course, current return uh the hope for appreciation or growth in the value of the security uh supplementing these two are various factors uh behind the stock; management, uh the assets that are available for earning a return, uh well, of course, the business that the company is in, prospects for that business, a general economy and the way the industry and the company relate to the economy.

Q. When you refer to growth, uh what connection, if any, does that have with what we refer to as a fair market value? What do you mean by growth of the security?

A. Well generally speaking, growth in the uh value of the security and it's reflected in the market or the willingness of somebody to buy it at a higher price. Uh this has been particularly important uh since the war, World War II, because of a general inflationary trend in the economy.

Q. When you refer to return, what are you, to what are you referring in this connection?

A. Well, I was referring to current return; either dividends or interest paid on the security that you purchase.

Q. Now, Mr. Mounger, you have been handed uh a resume entitled Factors Bearing On Fair Market Value of Class C Stock of the New Orleans Bank for Cooperatives copy

77 has been handed to opposing Counsel and also to the Court. I ask you whether or not you have familiarized yourself with uh these factors that's uh set out?

A. Yes, I have.

Q. Uh in that connection uh Mr. Mounger, would the provision referred to as Number 3, No Divisions, No Dividends Can Be Paid Upon The Stock, have any bearing upon the fair market value of such a stock or security?

A. Well I think it definitely would. There are security buyers that buy securities for current return dividends and uh this, in a sense, eliminates one sector of the market that buys securities because there's no current return.

Q. Referring to Item 10 of those factors uh providing if the directors so desire, a Class C Stock may be retired at par after retirement of all Class A Stock by calling the oldest outstanding stock and so forth. Uh what effect, if any, does the right of the directors, in their discretion to call the stock at par, have upon the growth factor in relation to the increased value of a security and particularly this security?

78 A. Well as I interpret this, this virtually nullifies uh the attraction from a growth standpoint. You redeem this at a hundred and the way I came to, calculated, it, in my opinion, uh money will doubled in value, let's say at 6%, in twelve years. You say 5% money will double in about fourteen years and where, in this instance, you have no assurance that this stock will be paid off within twelve years, or for that matter within fourteen, so as I would reason, uh you are giving them your hundred dollars. If you can take a hundred dollars and compound it at 6%, or let's say 5% if that rate is more applicable to the time, and compound money for fourteen years at 5% and double it, then if you give the bank a hundred dollars, they pay you no return and they wait fourteen years to give you back your hundred dollars, you've just thrown a hundred dollars away.

Q. Then, as a matter of fact, would there be any fair market value for such such security as is here described?

A. I wouldn't, I wouldn't think so. Not in the fields in which, uh not in the normal security channels and not with an investor that uh was knowledgeable in any way regarding money and it's value.

Q. Would there be any such as an investment for the investment of money?

79 A. I can't see how it would uh be attractive to anyone.

Q. That's your opinion?

A. That's my opinion.

By Mr. SATTERFIELD:

Q. Referring to uh other provisions of the stocks, would you refer to Item 11 uh stating forth that the bank has a first lien on all stock owned by any holder as additional security for any indebtedness of such holder but the value of such stock is not considered for loan purposes. Would you tell us whether or not that would also have an adverse effect upon the fair market value of the stock?

A. Well in my opinion it would. It would throw upon the purchaser of the stock almost the obligation to go and examine the cooperative and come to some conclusion regarding its soundness. Uh almost an unsummountable burden to arrive at uh to feel any confidence in the stock at all. Now this be uh a right sizeable problem uh in the case of any large business enterprise uh to appraise it and to say now this stock is is free from uh uh that their financial position is sufficient that the stock is uh there's no danger of the stock being taken
81 against their obligation, so I think it would definitely uh limit uh in a sense, destroy a market for the stock.

By Mr. SATTERFIELD:

Court will indulge me just a moment?

By the COURT:

Mr. Mounger, as I understand what you're saying is that in the field of security purchases that you generally represent that there would be no market for the purchase of this stock. Is that right?

By the WITNESS:

That's right, and I feel that anyone who actually found these facts, uh could have no basic interest in the stock. If uh money can double itself, if it's compounded at 5% in fourteen years, why buy a stock for a hundred dollars that you have no way of knowing whether they are going to pay you in fourteen, fifteen, or twenty years. And if they decide to redeem that stock at the end of fifteen years, then to my reasoning, you just give

them, just giving your hundred dollars away because you could have put that money at work and double it.

By the COURT:

Those are certainly very sound investment considerations, but it occurred to me that some of these people who
82 would buy this C Stock wouldn't exactly be voluntarily purchased, wouldn't be voluntary purchases. They couldn't get a loan maybe without buying some of this stock; they had to, just like they had to pay interest to get the money.

By the WITNESS:

Well now if——

By the COURT:

Counsel for the Government is concerned about my thinking but you'll find a lot of usury cases right along the line I've indicated and I know of at least two in the Supreme Court of the United States.

By the WITNESS:

Well on that score, Judge, it would seem to me the first share which qualifies them to get the loan would hold to that reasoning, but then the person would run from every other share because what, in a sense we're saying, is that the bank is making loans uh it might not, uh it might not normally make if it for it being a member, if it wasn't a member of the Cooperative Association. So what I'm saying, actually to my mind uh that destroys the value of the stock as stock because the, it implies that this bank is going to make loans on the basis other than just rigid credit standards.

By the COURT:

83 I don't understand it that way but I do understand that they wouldn't make a loan to anybody except a cooperative and they wouldn't make a loan to a cooperative unless he owned this stock.

By the WITNESS:

One share. What I'm saying, I agree on the one share but I don't see why they would buy one more share because they realize they are buying from a bank that is, is making a loan that may probably compromise sometimes from the rigid credit standards. In other words, I, I might buy a share of Deposit Guaranty to get my own loan but I wouldn't buy, wouldn't want to buy a lot of that stock if they were accommodating all their stockholders just because they were stockholders.

By Mr. SATTERFIELD:

Please the Court, may I call to the Court's attention that Mr. Verlander testified that the New Orleans Bank for Cooperatives has never sold a single share of C stock to any person other than the first qualifying share except under these requirements of the statute. We have no further questions of this witness.

CROSS EXAMINATION

By Mr. WARREN:

84 Q. Mr. Mounser, are you generally familiar with capital stock of New Orleans Bank for Cooperatives that we are concerned with here?

A. I think I am sir, yes sir.

Q. Well I uh as as an expert witness have you formed any opinion of judgment as to whether the amount of money paid for the uh C Stock in connection with investments uh whether that sum of money is an interest charge or a capital investment?

By Mr. SATTERFIELD:

Objection, may it please the Court. That's a legal question.

By the COURT:

That's probably what you're asking me, isn't it?

By Mr. WARREN:

Yes sir, as a matter of fact, that's true.

By the COURT:

I sustain the objection.

By Mr. WARREN:

Q. Mr Mounser, I think that I really have only one, one question that might a little bit but essentially it's going to be this. If uh, this is a big if, I'll grant you that. If uh it could be determined with some reasonable degree of accuracy
85 that a property, be it stock of this bank or other stock or some other property but if it could be determined with some reasonable degree of accuracy that you could re uh receive a return of your capital investment in that property at a uh predictable time and there was no provision for appreciation in principle value, that is, where the value of the stock itself is increased and there was no possibility for the payment of dividends on that stock but at the same time the management of uh the management concerned managing the property appeared to be as sound concerned business-wise had experienced losses in the neighborhood of one eighth of one percent over a great

number of years, if you could predict with some reasonable accuracy when you could get your money back, would it be possible uh to assign to that property a fair market value based upon discounting the value of the property?

A. Well in my judgment, now we're talking about this stock?

Q. No sir, I'm talking about the, about just properties in general.

A. I would say that basically uh an investor uh would want a maturity date. If we're talking, in other words, if we're going to arrive at a value uh by uh calculating uh what money's
86 worth, then they want a contractual maturity date which is the normal procedure in the security markets and that's the way, of course, you get your fluctuations in the the bond market. So what, it seems to me here, that uh uh this would be, would imply, try to imply to the stock the characteristics of the bond which are not present.

Q. Well now, you're you're, I think, trying to anticipate my next questions and I can outline them to you, they are rather relatively simple. Uh what is the term in the financial world, what does the term uh present value of a property mean? What is, what what does that term mean? You want to know the present value of an amount payable in cash in the future. Do you understand that terminology?

A. I would have to, now, now going back to the fair market value, and it's true of a bond or stock—

Q. Now Mr. Mounger, if you please—

My Mr. SATTERFIELD:

I object to interrupting the witness, Your Honor.

By the COURT:

I don't think Mr. Mounger understands his question.

I'll let you restate your question.

By Mr. WARREN:

87 Alright.

Q. In the, in the uh, does, does the term present worth of an amount payable in the future have any significance to you?

A. It does in relationship to a fixed maturity in a contractual date maturity, yes.

Q. The question, the next question this is if there is a security, the principal of which can be recaptured in a reasonably predictable period, at the end of a reasonably predictable period, could that security be given a fair market value?

A. I assume that it could if you could convince someone that uh yes, that's right.

Q. Well now getting on down, now getting the basic principles involved here, now getting on this New Orleans bank stock that we're concerned with presently. If you could establish a reasonably, uh a date when it could be reasonable to assume that you could get your money back out of this C Stock, could, could it be assigned a fair market value on the basis of discount principals?

A. If you could absolutely prove that uh the date that it was going to be redeemed, I think you could make that calculation. As I testified before, when you know what money, the time that it takes for money to compound, you've got to come
88 within those guidelines for it to be worth anything.

Q. Well now what were those guidelines again?

A. In other words, alright, money at 6% will double itself in twelve years. Money at 5% will double itself in fourteen plus years, fourteen and a fraction years. If you put in a hundred dollars the date that you get your hundred dollars back extends anywhere beyond those periods, then you've just thrown your money away because you could have taken that hundred dollars back in 1958 and 59 and invested it in a preferred stock and I think at that time the rate, a good preferred stock in a high grade utility, Mississippi Power & Light Company a 6% return, so you could have doubled the money if it was compounded. So uh the risk of uh various things, changes in the money market which could delay the redemption in this instance, uh make the uh make it almost impossible for anybody to say this stock will be redeemed in this year because uh while I know that 66 doesn't apply to this particular thing, but 66, for instance, none of us in the money market ever imagined we'd have credit crunches like we had in 1966 and nobody would have believed uh in 58 that the interest rates in the bond
89 market would be in the condition that it is in today. Uh that Government Bonds would be some selling at 6%.

Now these factors uh weren't known in 58 but they were a part of the risk of buying a share of stock that had no return

that was to be redeemed because these credit crunches slow down uh the ability to redeem. Uh it's possible, to my way of thinking, looking at this situation, that money could become so tight that farmers, uh cooperatives would slow down and almost stop their borrowing. This happens, this is the reason the Federal Reserve raises rates sometimes slows business enterprises down from using credit, so if rates go to such a level that the cooperatives say we're not going to borrow this year, we're going to wait until next year, they will buy less C Stock that will slow down the reduction of out-standing C Stock and prolong uh beyond any reasonable period uh as far as return is concerned, the redemption of the present C Stock outstanding.

Q. Are you uh familiar generally with the Class B Stock of New Orleans Bank for Cooperatives?

A. I've read these pamphlets and generally, yes, I am.

Q. Uh do you know what the limitation was on uh dividends on those stocks?

A. As I understand it, it was, top limitation was 4%.

Uh they could not pay less than 2, am I right, uh
90 and still distribute any C Stock.

Q. Alright.

A. Now this stock—

Q. But do you—

A. I don't—

Q. Pardon me. Go ahead.

A. I don't know the market but I would assume that uh the B Stock is selling at a very substantial discount.

Q. But do you know whether any, as I understand it, you said that an individual back during this period would have been foolish to have invested money in anything that wasn't paying as much as 6%, is that correct?

A. Well, it would have been foolish to have paid, to have bought a non-return stock that could not be redeemed anywhere, except a hundred dollars, in other words, had no growth factor in it at all, no return at all, and that his money might be in their hands for an indeterminable period when had he invested it at 6%, he could have doubled his money in twelve years. So, yes, I think an investor would have been, from an investment standpoint, would have been—witness mumbling and unable to understand—

Q. Now do you understand, Mr. Mounger, that an individual who invested his money in B Stock of the New Orleans Bank only had a right to uh get back his hundred dollars when the B Stock was redeemed. You understand that, don't you?

A. Right. I do.

Q. All right. And you also understand that should the bank decide not to pay any patronage refund that it didn't have to make any dividend declaration on the B Stock. You understand that, don't you?

A. 2%, am I right? No, no, I thought they had to pay at least 2%.

Q. If they, if they decided to uh issue uh patronage refund, but if they didn't issue any patronage refund, it's my understanding that they didn't have to pay anything on the B Stock. Is that your understanding of it?

A. Well, I'm not, I'm not clear on that point. I, I was thinking that they paid 2% but uh I don't think it makes any real difference.

Q. But uh the point I'm making is that an individual buying a share of B Stock uh under the law could, could not, could not be assured that he was going to get any dividends on the stock—

By Mr. SATTERFIELD:

Objection. That's a question of law, may it please the Court. That's before the Court on stipulation.

92 He's asking under the law what he might get.

By the COURT:

Yes, I sustain the objection.

By Mr. WARREN:

Q. Well just just so I'm sure that I understand your testimony, Mr. Mounger, this is the real, the crux of my question to you. If you could determine with some reasonable degree of accuracy the time at which the uh Class C Stock would be retired and you could get your hundred dollars back that you paid for the C Stock, could the stock be given a market value?

By Mr. SATTERFIELD:

Please the Court, object on repetition. It's been covered very fully.

By the COURT:

Yes, I think he's answered that. Sustain the objection.

By the WITNESS:

Should I answer the question?

By the COURT:

No, sustain the objection. Ask him something else.

By Mr. WARREN:

Just for my information. The objection was made on the ground that the witness answered the question?

By Mr. SATTERFIELD:

93 On the ground of repetition.

By the COURT:

That's what I sustained it on. You asked him the same question at least twice.

By Mr. WARREN:

Q. You have stated, Mr. Mounger, that you have uh been in the investment field, brokerage business, for 29 years, most of the time, except for time out for service and some Government time, I believe?

A. Yes sir.

Q. Have you ever attempted to uh put a market value on any stock like this before?

A. Well I've attempted to put a market value on stock—

Q. Or make a determination—

A. Or securities.

Q. Yes sir.

A. Right.

Q. Yes sir.

A. Sure, I have.

Q. What was the nature of those securities?

A. Well, say one, School Pictures which is a common stock. In other words in underwriting a situation, try to arrive at a price at which we bring the stock and this is, a number of situations where I participated in that type of—

94 Q. No. I'm talking about evaluation of a security where it can only be traded between members of a restricted group?—

A. Oh, no, I haven't.—

Q. And where they don't pay any dividends and you can't uh redeem them until a future time—

A. No. I'm relating my experience in the security market generally to this situation. I haven't done this specific thing before, no.

Q. This, this is not, this is a unique type of security, isn't it, Mr. Mounger?

A. I would say most unique, most unorthodox, yes.

Q. Yes sir.

By Mr. WARREN:

May I consult with Mr. O'Farrell for just a moment, please?

Q. Thank you very much, Mr. Mounger.

(Witness excused.)

By Mr. SATTERFIELD:

The Court will indulge us for just a moment, we may be in a position to rest.

By the COURT:

All right.

(Counsel for Plaintiffs conferred.)

By Mr. SATTERFIELD:

95 May it please the Court, the Plaintiffs rest.

By the COURT:

All right. What says the Defendant?

By Mr. WARREN:

The Defendant calls Mr. H. C. Polk.

HIRAM C. POLK CALLED as a witness for and on behalf of the Defendant, was sworn and testified as follows:

DIRECT EXAMINATION

By Mr. WARREN:

Q. Please state your name?

A. Hiram C. Polk.

Q. Where do you live, Mr. Polk?

A. Jackson, Mississippi.

Q. What is your occupation?

A. I'm Comptroller of Mississippi Federated Co-Op, more recently known as M.F.C. Service.

Q. How long have you been uh associated with that organization?

A. 28 years.

Q. And in what capacities, please sir?

A. Chief Accountant for 18 years and Comptroller for 10 years.

Q. Uh were you Comptroller of uh Mississippi Federated Cooperatives uh during 1964?

A. Yes.

97 Q. Uh do you have, well, just let me ask you a question. Did the uh Mississippi Federated Cooperative acquire uh any of the Class C Stock of the New Orleans Bank for Cooperatives from an organization known as uh Associated Cooperatives in May of 1964?

99 By Mr. WARREN:

Q. Did, did, uh do you recall the question or would you like for me to repeat it?

A. Repeat the question, please.

Q. Did Mississippi Federated Cooperatives acquire Class C Stock of the New Orleans Bank for Cooperatives from Associated Cooperatives in May of 1964?

A. Yes.

Q. Do you, have you brought in any records of Mississippi Federated Cooperatives which would show the amount of that stock that Mississippi Federated Cooperative acquired at that time?

By Mr. SATTERFIELD:

May it please the Court, we renew our objection on the same ground that has heretofore been entered and that is this is a transaction, apparently, an isolated transaction subsequent to the time here involved which could not have any bearing upon the matters involved up June 30th, 1963.

By the COURT:

101 Q. Uh do you recall the question, Mr. Polk, or shall I restate the question?

A. Restate it, I.

Q. You have stated that in May, would, would you understand what I mean if I used the term, M.F.C.?

A. Yes.

102 Q. And that means Mississippi Federated Cooperatives, doesn't it?

A. No answer.

Q. Please answer, Mr. Polk, for the record?

A. Yes, yes—

Q. You understand—

A. I'm sorry. Yes, I understand M.F.C., yes.

Q. Means Mississippi Federated Cooperatives?

A. Right, yes.

Q. All right. Have you brought in with you records of M. F. C. which shows the amount of stock acquired, of Class C Stock acquired from Associated Cooperatives in 19, May of 1964?

A. I have.

Q. And uh you have given me copies of those documents. Will you describe the document whereon that information is listed?

A. First, in compliance with the, with the subpoena, it asks for the original check wherein we purchased, or rather M. F. C. purchased uh Class B and Class C Stock from Associated Cooperatives, who was in the process of being liquidated. So here is Mississippi Federated Co-Op's check, 021414, dated May the 29th, 1964, issued to Associated Co-Op in Sheffield, Alabama for twenty seven thousand dollars, which represents the purchase of fifteen thousand dollars of B Stock and also, some 103 twenty seven thousand four hundred dollars of C Stock for which we paid twelve thousand dollars.

Q. All right.

By Mr. WARREN:

Now, if it please the Court, I uh have a copy of the check to which the witness has made reference and if it please the Court, I would like to uh offer in evidence that check and substitute a copy for the record.

By the COURT:

I think to lend any value to his testimony, you have to show the circumstances under which they bought this property. I'm in the dark on that. The fact that he bought some stock doesn't mean a thing in the world to me. I don't know whether it was a voluntary sale or a forced sale or what kind of sale it was. If you want to develop that, you may do so.

By Mr. WARREN:

Q. Mr. Polk, have you brought the entire correspondence file of M. F. C. with you relating to the purchase and sale of that, of that stock?

A. Yes sir, I have.

Q. Do you have uh any uh document in that file that would indicate how the uh transaction arose?

104 A. I have the documents here. They may not be in the sequence that the Court wishes but I have the documents

here. First, we have the invoice of Associated Co-Op to uh support the check that we issued. We also have a report from—

By Mr. SATTERFIELD:

Excuse me just a moment. May it please the Court, I haven't had opportunity to view this. Would it be appropriate since he is about to testify from the file for me to review the file briefly so I would be in a position to know whether or not objection should be made?

By the COURT:

Well, let me ask him this. Are you familiar with the circumstances and conditions of your own knowledge of the acquisition of this stock?

By the WITNESS:

Yes sir.

By the COURT:

You might just ask him about this, aside and apart from what his file shows.

By Mr. WARREN:

Q. All right, sir, state to the Court, Mr. Polk, how this uh transaction came about:

A. It, it was a combination of interests. Mississippi 105 Federated's Manager, Charlie McNeil, was a director of Associated. We were one of their best customers volume-wise and when the liquidation began, Mr. Spivey, who was General Manager at that time and succeeded Mr. McNeil, knew of uh the liquidation of Associated and so uh Neo Pendelton was then President of New Orleans Bank and it was a negotiated combination transaction between the President of the New Orleans Bank uh the General Manager of M. F. C. and the uh and the uh Liquidation Committee of Associated Co-Op. And M. F. C. purchased it in an effort to uh assist the stockholders of Associated so they would receive that much more in the uh final disposition or dissolution. And also, if I might state, at that time, M. F. C. had acquired quite a sum of Class B Stock. In fact, at that time, we owned about four hundred and sixty three thousand dollars of Class C Stock of which we uh entered onto our records at the full face value. This was upon instructions received from the lender that the cooperative take into account debiting his investment account and also crediting uh the uh other revenue when we took it in. So M. F. C. is in

the position of having recorded all of the uh patronage surplus and so forth from the N.O.B.C. and also we have in turn
 106 allocated it to the various patrons who do business with M. F. C. So we have considered it at the full face value based upon the instructions from the bank.

By Mr. WARREN:

Q. Mr., Mr. Polk, getting back to the issue at hand: What was the par value of the stock that was purchased from Associated?

A. The par value of the B Stock was a hundred and fifty shares for fifteen thousand dollars which we paid cash for, and the value of the C Stock, based upon the bank's analyst, was, pardon, was twenty seven thousand four hundred and eight dollars and thirty nine cents plus nine thousand two hundred and seventy four dollars and seventy nine cents which would equal something in excess of thirty six thousand for which our General Manager bid twelve thousand dollars on it.

By the COURT:

What was the other plus there?

By the WITNESS:

Uh it was twenty seven thousand four hundred and eight dollars and thirty nine cents Class C Stock.

By the COURT:

For C Stock?

By the WITNESS:

107 Yes, sir, an allocated surplus, nine thousand two seventy four seventy nine.

By the COURT:

Two seventy four?

By the WITNESS:

Two seventy four seventy nine.

By the COURT:

All right. You want that check marked in evidence?

By Mr. WARREN:

Yes sir.

By the COURT:

It may be entered and be marked.

(Received in evidence and marked as Defendant's Exhibit No. D-1).

By Mr. WARREN:

Q. Now you said that you had also brought an invoice along. Uh the uh do you have the copy, the original of that invoice before you, or your office copy?

A. Yes.

Q. After, after Associated Cooperatives and Mississippi Federated Cooperatives entered into the agreement for the purchase and sale of the B & C Stock, uh did uh Associated Cooperatives send you a bill for the amount that you agreed to pay?

A. They did.

108 Q. And do you have a copy of that invoice?

A. Yes sir.

By Mr. WARREN:

I would like that marked as an exhibit to his testimony, please sir.

By the COURT:

Show it to Counsel.

By Mr. WARREN:

May we substitute a copy for the record, please?

Q. You want to take that back, do you not, Mr. Polk?

A. Yes.

By the COURT:

What about that check?

By the WITNESS:

We had a photostatic copy of it and submitted it to the Clerk.

By the COURT:

Oh. All right, that invoice may be entered and be marked.

(Received in evidence and marked as Defendant's Exhibit No. D-2).

By Mr. WARREN:

Q. Now, have you also brought in a copy of the M.F.C.'s uhuh investment ledger?

A. Yes sir, I have and I have it before me.

109 Q. And uh what, what, how was the C stock acquired from uh, well first of all, was the C Stock acquired from Associated Cooperatives entered on that ledger sheet?

A. It was entered and you say how was it entered?

Q. Was it entered?

A. It was entered as an investment on the Class C Stock ledger card.

Q. And uh for the benefit of the record, would you state the date of the entry and describe otherwise the entry?

A. The entry was made by the accounting staff on May the 29th, it was recorded from the copy of the original voucher and it reflected this information: B Stock, fifteen thousand dollars; C Stock, par value, excuse me. B Stock, par value, fifteen thousand dollars; C Stock, par value, twelve thousand dollars, and an entry was also made to—

Q. Excuse me, you say C Stock par value—

A. That's the way the record reads here.

Q. What, what after you said C Stock, par value, what was the net figure?

A. Twenty seven thousand, four eleven thirty one.

By the COURT:

I thought you said twenty-seven—

110 By the WITNESS:

Yes sir,—

By the COURT:

Four 0 eight thirty nine?

By the WITNESS:

Well there was a change in the patronage for that year for a couple of dollars in the close out, Judge. It was twenty seven, the analyst from the bank reported twenty seven thousand four 0 eight thirty nine, and the uh uh Associated records showed twenty seven thousand four eleven thirty one. There was a couple of dollars variation in the uh records.

By the COURT:

While I'm talking to you, you said you paid twelve thousand dollars as the negotiated price for this stock and you received a surplus of ninety two seventy four seventy nine. So you paid something less than three thousand dollars for the stock, didn't you?

By the WITNESS:

We paid twelve thousand dollars for the twenty seven thousand four hundred plus the ninety two hundred. We would have paid twelve thousand dollars for the uh B Stock and the uh surplus.

By the COURT:

111 That's what I'm asking you about. You didn't put out but about three thousand dollars then, is that right?

By the WITNESS:

No sir, the total outlay was fifteen thousand, we put out twenty seven thousand.

By the COURT:

I'm just talking about the C Stock.

By the WITNESS:

Oh, the C Stock. Uh.

By the COURT:

You got a surplus ninety two seventy four seventy nine plus the C Stock twelve thousand dollars—

By the WITNESS:

Right.

By the COURT:

As I understand it.

By the WITNESS:

We paid twelve thousand dollars for the C Stock value plus the surplus. So we bought thirty six thousand dollars of investment value for twelve thousand dollars cash, so we would have paid about thirty cents on the dollar, sir.

By the COURT:

That's what I was trying to find out. You didn't get that cash. you just got a credit—

112 By the WITNESS:

That's correct, I'm sorry, I didn't, the bank made the appropriate transfer on their records from Associated Co-Op to M. F. C.'s records, right. I'm sorry.

By Mr. WARREN:

Q. All right, back to the ledger sheet and M. F. C.'s accounting treatment of the item. Uh I note there under, under the description headed to bring C Stock prescription from Associated up to par, now will you explain to the Court what that means?

A. Inasmuch as we had purchased twenty seven thousand four hundred and eight dollars, in one instance, let's let's get this clear. In one instance the records, Associated records shows

twenty seven thousand four eleven. The bank's records shows twenty seven thousand four 0 eight.

By the COURT:

Thirty nine?

By the WITNESS:

Yes. Is that clear? Now—

By the COURT:

No sir, that's not clear.

By the WITNESS:

(Laugh) Well that's what the variation in the two
113 corporate records and that's where the, in other words, there was a non-reconciling item in there of two dollars but in answer to your question, the entry that was made by M. F. C. was to bring the, the par value of the C Stock purchase to it's full face value.

By Mr. WARREN:

Q. Full face value uh with respect to what?

A. Full face value as shown on the N.O.B.C. records and also those of uh Associated Co-Op's.

Q. All right, sir.

By Mr. WARREN:

I ask that the ledger sheet be uh uh made an exhibit to his testimony and uh a copy substituted for the record.

By the COURT:

Show it to Counsel. Do you have a copy?

By Mr. SATTERFIELD:

Yes.

By the COURT:

All right. It may be entered and be marked.

(Received in evidence and marked as Defendant's Exhibit No. D-3.)

114 By Mr. WARREN:

Q. While I'm looking through here, Mr. Polk, uh did, did uh M. F. C. borrow money from the uh New Orleans Bank for Cooperatives during uh 1963 and prior years?

A. Yes sir.

Q. For how many prior years did it borrow money, if you know?

A. M. F. C. has been indebted to New Orleans Bank for Cooperatives for the past 28 years, to my personal knowledge.

The loan may have been paid in full three times at the end of the farming season, Judge, but they've been indebted to them for some amount for the past 28 years.

Q. Did uh M. F. C. receive any indication uh by way of letter from the New Orleans Bank uh as to the uh way the transaction was recorded on its books, that is, the bank's books?

By Mr. SATTERFIELD:

Please the Court, we object, it's not material. We've introduced the ledger in which it is shown on all these various entries made on the bank, of the New Orleans Bank for Co-
115 operatives in dollar amount relating to the full par amount.

By the COURT:

I don't think it's material how he carried it on his books.
Sustained.

By Mr. WARREN:

Did you say—

By the COURT:

Sustained.

By Mr. WARREN:

On the books of the Bank?

By the COURT:

On his books.

By Mr. WARREN:

I'm asking if his organization received from the bank a letter indicating how the bank treated this transaction. How it went about transferring the credits, et cetera, on its books.

By Mr. SATTERFIELD:

Please the Court, we object as immaterial.

By the COURT:

I didn't understand the question like that but now I understand it and I still make the same ruling.

By Mr. WARREN:

All right, sir.

By the COURT:

116 You may get his answer for the record, if you wish.

By Mr. WARREN:

Q. Yes sir, for the record. Will you answer that question for the record, please sir?

A. The President of the Bank, who is deceased, advised our general manager that they were making the appropriate transfers from Associated Co-Op to M.F.C. on their books.

Q. And uh do you have the letter by which that advice was given?

A. Yes, it was signed by Neal Pennington and dated uh in May, 1964, yes.

Q. Does that letter to which you refer bear the letterhead of the New Orleans Bank for Cooperatives?

A. Yes sir.

Q. And you say that it indicates the manner in which the bank uh treated the stocks on its books?

A. Yes sir.

By Mr. SATTERFIELD:

May it please the Court, to save time, that's the only reason I made objection subject to our general objection to this line of testimony as being improper time, I see no reason why this shouldn't be marked as an exhibit; might save us some time.

By the COURT:

117 I was just letting him make the record. I sustained your objection. You've got a letter there that shows—

By Mr. WARREN:

Yes sir.

By the COURT:

How he carried it? I'll let it be marked for identification—

By Mr. WARREN:

Marked for identification.

By the COURT:

Right.

(Marked for identification as Defendant's Exhibit No. D-4).

By Mr. WARREN:

And I offer in evidence all the uh documents which have been given exhibit numbers for the Defendant.

By the COURT:

Is there any objection to any of those documents?

By Mr. SATTERFIELD:

We object, may it please the Court, on the same grounds that—

By the COURT:

No, I mean the documents he previously offered for identification only. He says he's now offering all of them in
118 evidence and my question is whether or not you have any objection to any of those documents?

By Mr. SATTERFIELD:

May it please the Court, I have no further objection to those heretofore made but I do reiterate on the basis of uh that they should not be introduced in evidence as we objected to them being identified on the ground as stated a moment ago. I assume he's referring to the recent documents.

By the COURT:

How many documents have we got? We've just got to take a little sharper bead on that. How many documents have you got that you are offering in evidence now?

By Mr. SATTERFIELD:

Are you referring, if I may inquire of Counsel, are you referring to those which have been handed to the reporter?

By Mr. WARREN:

Yes sir, and I believe there are three of them, three or four,

By Mr. SATTERFIELD:

Three or four?

By Mr. WARREN:

There were four; there was a check, and an invoice
119 and a ledger and the letter from Mr. Pendleton.

By the WITNESS:

Right.

By the COURT:

Now my ruling might be quite different. I've admitted the check in evidence. It wasn't offered for identification. It's been admitted in evidence. What else are we talking about? You've got that so marked, haven't you?

By the CLERK:

Yes sir.

By Mr. WARREN:

I didn't understand you, sir.

By the COURT:

The check is marked in evidence.

By Mr. WARREN:

All right, sir, then I offer in evidence uh the documents, the invoice which I thought had been given uh an identification number.

By the COURT:

I think that was marked in evidence too.

By the CLERK:

Yes sir.

By Mr. WARREN:

All right, sir, then the ledger sheet?

120 By the COURT:

Marked in evidence.

By Mr. WARREN:

And uh the letter from Mr. Pendleton, has that been marked as in evidence?

By the COURT:

For identification.

By Mr. WARREN:

I offer that, the letter from Mr. Pendleton which has been given identification, Exhibit Number, Defendant's Exhibit Number 4, I offer in evidence.

By the COURT:

Yes sir, I sustain the objection and that letter may remain marked for identification.

By Mr. WARREN:

Thank you, Your Honor.

CROSS EXAMINATION

By Mr. SATTERFIELD:

Q. Mr. Polk, you had mentioned the fact that uh M.F.C. was one of the stockholders and best customers of Associated, and is it not a fact that Mr. Charles McNeil was, for a number of years, both the General Manager of M.F.C. and a Director of Associated?

A. That is true.

Q. And he was succeeded as General Manager of
121 M.F.C. by Mr. Spivey, was he not?

A. That's correct.

Q. Mr. Ernest Spivey?

A. Right.

Q. Is it not also a fact that at this time, Mr. Ernest Spivey was a Director of the New Orleans Bank for Cooperatives being a member of the Regional Farm Credit Board?

A. He is.

Q. Also he has recently become President of the New Orleans, I mean Chairman of the Board of the New Orleans Bank for Cooperatives, hasn't he?

A. I understand that he has. I haven't seen any documents on it but I understand that he has.

Q. Now during this period of time uh the uh M. F. C. was indebted to uh the New Orleans Bank for Cooperatives in the amounts, as of the end of the year, between uh three to seven million dollars, was it not?

A. Correct.

Q. For instance, in 19 uh 63, the amount of indebtedness was a little over five million dollars at the end of the fiscal year, was it not?

A. Correct.

Q. 1964 it was a little over seven million dollars?

A. Correct.

122 Q. Now during the time that the Associated went into uhh, excuse me. Mr. Polk, is it not a fact that at the time that the Associated went into liquidation that the M. F. C. owed a balance of certificates of indebtedness of Associated to M. F. C. of fifty six thousand a hundred and seventy eight dollars and eighty three cents?

A. You are correct.

Q. And also at that time that there was owed by Associated to M. F. C. as the balance in the patrons' equity investment account of sixteen thousand three hundred and forty two dollars and twenty eight cents?

A. Correct.

Q. Do you not have there a schedule of the uh various amounts uh these amounts and other similar amounts set forth therein?

A. Yes sir, I have.

By Mr. SATTERFIELD:

We'd like to introduce this as an exhibit to the testimony of the witness.

By Mr. WARREN:

Uh I really don't know what it's about, Your Honor, but mostly I object, well, I object to the introduction of the documents on the grounds that it's not relevant and material
123 here. I don't see where it is.

By the COURT:

What's the materiality of it?

By Mr. SATTERFIELD:

May it please the Court, it demonstrates, with all the facts heretofore testified, this is not an arm's length transaction but a transaction where the three parties were, had mutual officers,

mutual interests, there were mutual indebtednesses between the three, and it was done as a matter of accommodation—

By Mr. WARREN:

There's no evidence in the record to sustain that charge.

By the COURT:

I'll let him pursue that a little bit further.

By Mr. SATTERFIELD:

We offer this as uh an exhibit at this time.

By the COURT:

Well I'll let you pursue that a little bit further before passing on that.

By Mr. SATTERFIELD:

Oh.

Q. Mr. Polk, as a matter of fact, under all the circumstances, this transaction was a matter of accommodation as between M. F. C., Associated and N.O.B.C., was it not?

A. It was.

Q. And done for the accommodation of the parties, was it not?

A. Yes sir.

By Mr. SATTERFIELD:

We offer this, may it please the Court, as an exhibit to the testimony of the witness.

By the COURT:

It may be entered and be marked, be marked for identification at this time because, as I understand it, you are not putting on your testimony now.

By Mr. SATTERFIELD:

Unless Counsel would permit this—

By the COURT:

He hasn't rested.

By Mr. SATTERFIELD:

To be offered in evidence at this time.

By the COURT:

He hasn't rested.

By Mr. WARREN:

I wouldn't mind offering it. I'm going to object to it but he can go ahead and—

By the COURT:

You've already objected to it and I overruled your objection.

125 I'll let it be marked for identification at this time and you can offer it later.

(Marked for identification as Plaintiff's Exhibit No. P-4).

By Mr. SATTERFIELD:

Q. Now, Mr. Polk; as a matter of fact is it not your opinion that C Stock of N.O.B.C., New Orleans Bank for Cooperatives, does not have, actually have a fair market value?

By Mr. WARREN:

I object, Your Honor. He's not qualified to give an opinion on that subject.

By the COURT:

I'll let you ask him a little bit about that and see what he knows.

By Mr. SATTERFIELD:

Q. How long have you been uh uh in connection with M. F. C., or otherwise have you been knowledgeable about or dealing in connection with the N.O.B.C. C Stock?

A. When it was first introduced, I don't recall when that was. I've been familiar with that, I've been familiar with their over-ride requirements, the 15%, the 10%, in fact, I have approved most of the interest payment in our organization. Uh I've been conscious of it ever since it was initiated.

126 Q. Have you been familiar with the use of the stock, the requirement for the payment of an over-ride uh and the entry or issuance of stock ever since the new act went into effect about 1955 or 6?

A. Yes sir.

Q. Are you also familiar with the fact that uh patronage uh refunds or dividends have been distributed in the form of C Stock by entry upon the books of the New Orleans Bank for Cooperatives?

A. Yes sir.

Q. During that period of time, have you become familiar with whether or not there is a fair market value and where dealing is at arm's length for C Stock of the New Orleans Bank for Cooperatives? Have you become familiar with that?

A. I, I'm not familiar that there is a fair market value.

Q. Then would you give us your opinion as to whether or not there is a fair market value when parties are dealing at arm's length on the basis where you have a willing seller who

offers to a willing buyer and neither one being under compulsion to buy or sell?

By Mr. WARREN:

I object, Your Honor, I still don't think the man's qualified. He he's comptroller of that company but uh couldn't
127 say that by training or experience to make a statement that would be worth to the Court.

By the COURT:

I don't think you have to do much to qualify as an expert on value but I'll let you ask him that question if you want to phrase it a little bit differently to find out what his opinion is of fair market value.

By Mr. SATTERFIELD:

Q. Mr. Polk, from the knowledge and experience you've had which you have outlined, what is your opinion as to whether what, what, if any, amount is the fair market value of N.O.B.C. st, C. Stock where you have a willing seller offering to a willing buyer with no compulsion, where the two act at arm's length?

A. It has no value.

Q. Thank you, sir.

By the MARSHAL:

Anything further?

By Mr. SATTERFIELD:

Just a moment and let me see. I have one more question.

Q. Is not the M. F. C. an exempt cooperative?

A. It is.

Q. Is it, therefore, not exempt from the payment of any income tax?

128 A. It is totally exempt except when we make an error of some minor nature.

Q. And where it is discovered too late to rectify it during the period?

A. That's right.

Q. Then it is a fact, is it not, that whether or not you should enter this C Stock at the face value, or par value, at one dollar or any other amount, has no effect whatsoever upon the taxation of M. F. C., isn't that correct?

A. It does not have any effect at all.

Q. So that if this had been entered at one dollar per share, the tax effect upon M. F. C. would have been identical with the entry thereof at one hundred dollars per share, would it not?

A. Correct.

Q. Now at this time, could you tell us how much uh C Stock was owned by M. F. C. in the term of dollars reference to par value?

A. At what date?

Q. As of May, as of uh uh prior to this particular transaction as of April 20, April 15th, 1964?

A. April the 15th, 1964, the balance was uh four hundred and forty thousand two 0 three forty eight.

Q. Uh since uh this uh transaction to which you have referred as an accommodation transaction between the corporations has taken place, has M. F. C. utilized the C Stock or the allocated surplus thus uh acquired by it in any manner in connection with it's loans from the New Orleans Bank for Cooperatives?

A. No.

By Mr. SATTERFIELD:

Q. If it were not for the fact to which references is made uh from which this accommodation transaction arose with the inter-play between Associated, M.F.C., N.O.B.C. and each other, uh would Mississippi Federated Cooperatives have purchased this stock?

A. We would not without the, may I say, personalities involved, we would not make such a purchase today.

Q. Or that day either, right?

A. No because of the direct cash out-flow and it's value for it's loan value, we would not.

By Mr. WARREN:

Mr. John O'Farrell.

JOHN O'FERRELL called as a witness for and on behalf of Defendant, was sworn and testified as follows:

DIRECT EXAMINATION

By Mr. WARREN:

For the record, for the record, let me say that Mr. O'Farrell's name is O apostrophe F-A-R-R-E-L-L.

Q. Please state your name for the record?

A. John O'Farrell.

Q. Where do you live, Mr. O'Farrell?

A. In Chevy Chase, Maryland.

Q. What is your occupation?

A. I'm an Evaluation Engineer.

Q. Do you mean by that that you are employed as Evaluation Engineer?

A. I'm employed by the Internal Revenue Service as Evaluation Engineer.

Q. Where do you maintain your office?

A. In Washington, D.C.

Q. How long have you been Evaluation Engineer for the Internal Revenue Service?

A. A little over eight years.

Q. What is your formal education background, Mr. O'Farrell?

A. Public Schools of West Virginia, Bachelor of Science in Civil Engineering from West Virginia University, and uh Master of Arts in Economics from George Washington University.

Q. Briefly outline your business experience prior to the time that you went to work for the Internal Revenue Service as Evaluation Engineer?

A. I worked uh twenty five years for three different railroads, the Chesapeake & Ohio, the Virginia and the Norfolk & Western. With the Chesapeake & Ohio, I was Assistant Cost Engineer; with the Virginia, I was the Cost Engineer and Assistant
133 to the General Manager, and with the Norfolk & Western, I was Assistant Superintendent of Transportation.

Q. During the seven years that you have been Evaluation Engineer for the Internal Revenue Service, what has been your duties?

A. I have been assigned to evaluation of problems arising out of litigations.

Q. What, what type subjects were involved in the uh litigations?

A. All types of properties, securities, including stocks and bonds, warrants and patterns, and lease homes, and going concerns, industrial plants, machinery, various uh property items.

Q. Now do I understand that you have uh appraised that sort of property?

A. Yes sir.

Q. During the time that you have been with the Internal Revenue Service, how many uh separate property appraisals have you made, by way of estimate?

A. Several hundred.

Q. Uh amongst the properties which you stated that you have valued or appraisals was uh stocks and bonds, uh how many appraisals of corporate stock have you made since 134 you have been with the Internal Revenue Service?

A. Possibly two hundred.

Q. Have you had occasion to appraise bank stocks?

A. Yes sir, several occasions.

Q. Do you belong to any professional society or group of appraisers?

A. I belong to the Association of Federal Appraisers, The Washington Financial & Analysts Association, The American Railway Engineering Association, and the Geological Society of Washington.

Q. Have you testified before as an expert on property values?

A. Yes sir.

Q. In what Courts, please sir?

A. In uh four Federal District Courts and uh several times in the Tax Court.

Q. Have you appeared as an expert witness in hearings conducted before Government Agencies?

A. Well while with the railroads, I appeared before the Interstate Commerce Commission and the Virginia Corporation Commission.

Q. Do you have an agreement to be paid any special compensation for appearing here to give your witn, to give your testimony in this case?

A. No sir.

135 Q. Will your compensation from the Government be increased if the Government wins this case?

A. No sir.

Q. Have you, at my request or at the request of the uh Internal Revenue Service, made an appraisal of the Class C Stock of the New Orleans Bank for Cooperatives as of the end of the fisc, the end as of the fiscal years ended June 30th, 1958, 59, 60, 61, 62, and 63?

A. I have.

Q. When, approximately when did you complete your appraisal?

A. In June of this year.

Q. What was the purpose of the appraisal?

A. To uh make an estimate of the fair market value of the stock at these different dates.

Q. What do you understand the term, fair market value, to mean?

A. It would be the price or value determined by a willing buyer and a willing seller, neither under compulsion and both with reasonable awareness of the pertinent facts affecting the value.

Q. What are the factors that you took into account in arriving at a fair market value estimate of the Class C Stock of the New Orleans Bank for Cooperatives?

136 A. I reviewed and considered the various factors that are generally considered in the evaluation of stock and they generally include the history of the enterprise, its uh success in maintaining its position in its industry, the conditions of the industry, the conditions of the economy as a whole, the earnings record of the enterprise, the dividend record, its uh asset compensation, its net worth, its management and uh public acceptance and response to it as a uh industrial or financial enterprise, and in particular instances, there are other factors that will be given consideration also.

Q. Based upon all the factors which you have described, what is your considered opinion as to the fair market value of Class C Stock of the New Orleans Bank for Cooperatives as of June 30, 1958, 59, 60, 61, 62, and 63?

A. Taking the six years in order, from 1958 through 1963, and considering a hundred dollar par value per share of stock, I have estimated the fair market value of the stock on these different occasions as three dollars and forty two cents; seven dollars and a half; fourteen dollars and thirteen cents; twenty four dollars and sixty five cents; twenty nine dollars and sixty cents; and thirty nine; thirty eight dollars and sixty five cents.

Q. Did you arrive at that, uh at those values, Mr. O'Farrell, based on, amongst other things perhaps, math, mathematical mechanics?

A. I come to the conclusion that the value indications will be found by determining what was the present value of the return of the principal to the owners of the stock at some estimated

future date. And to determine that; it required some mathematical figuring.

Q. All right, sir.

By Mr. WARREN:

If the Court please, I would like to give the Court a copy of that.

Q. Do you have with you, Mr. O'Farrell, a copy of the computations that you made?

A. Yes sir.

Q. Uh I have handed opposing Counsel for the Plaintiff a copy of the uh computation which you have made and also the Court, and uh I will ask you, Mr. O'Farrell, if you will explain to the Court how you went through the various steps in arriving at the fair market value as to uh which you have come to?

By Mr. WARREN:

Uh and if I may, I would like to have a copy of the
138 computation marked as an exhibit so that if we have to refer to it, the record will show what we're talking about. I intend to offer it once we are through with it.

By Mr. SATTERFIELD:

May it please the Court, may I inquire if this is offered for identification only, at this time?

By Mr. WARREN:

It is for the purpose of identification only, at this time.

By the COURT:

It may be marked for identification.

(Marked for identification as Defendant's Exhibit No. D-5).

By Mr. WARREN:

And let me say that that exhibit consists of one, two, three, four, five, six, seven pages.

Q. All right, Mr. O'Farrell—

By the MARSHAL:

Will you speak up a little, please?

By Mr. WARREN:

Yes sir.

Q. Mr. O'Farrell, will you, will you explain to the Court uh how you arrived at the, at the figures?

A. The uh Class C stock retirement in the uh rotating
139 cycle would follow the Class A and the Class B Stock's retirement. So the first uh estimate to be made is when

the Class A Stock would be retired. They were at the time which this is being considered which is June 30th, 19—

By Mr. SATTERFIELD:

May it please the Court, May I request the witness to talk a little more loudly?

By the WITNESS:

Yes, sir.

By the COURT:

Speak up, please sir.

By the WITNESS:

Yes sir. As of June, the 30th, 1958 there was outstanding six million five hundred and seventeen thousand par amount of Class A Stock.

By Mr. WARREN:

Q. Mr. O'Farrell, if I may interrupt you at this time. You say see attachment number one, and uh is that where you got the uh six thousand, or six million, five hundred and seventeen thousand dollars?

A. That's where I have it copied down, yes sir.

Q. Uh where did you get the information shown on attachment number one?

A. From the Annual Report of the Bank for Cooperatives in New Orleans and from the Annual Report of the Farm Credit Administration.

Q. All right, sir. You may proceed. I would just like to point out that those documents to which Mr. O'Farrell has referred, are the attachments with the stipulation.

A. In 19 and 58, there had been two hundred and twenty nine thousand, eight hundred dollars worth of the Class A Stock retired. So taking a conservative view of the future in assuming that no more would be retired in the future years than was retired in the Year, 1958, the number of years required to retire the Class A Stock, if it was evenly retired like it had been in 1958, it would have been twenty eight and six tenths years, which is obtained by dividing the Item A by the Item B. Now during this period, the Gov, the Government was receiving a Franchise Tax on the stock annually and in the Year, 1958, the Franchise Tax was fifty thousand a hundred and one dollars. It was determined by a formula set up in the statute and at a future date when the Class A Stock would be reduced to a certain level which was determinable by simple arithmetic, the

Franchise Stock, the Franchise Tax would start declining because when it reached a certain, certain point, the
 141 other provision in the law would take effect, and that provision was that the bank did not have to pay to the Federal Government more Franchise Tax than the Principal amount of the stock multiplied by the average interest paid by the Government on the public debt issues made in the year preceding the date on which they had to pay the tax. Now that sounds somewhat complicated but as the Class A Stock declined, uh there would be a stage reached which, on the use of the 5% interest rate, was when the stock got down to a million and two thousand dollars. And the purpose of this rather, what seems to be rather complicated, calculations is to find what effect that decline in the Franchise Tax will have on the length of time that it would take to retire the Class A Stock, and by this calculation, it came up to a half a year.

Q. Mr. O'Farrell, you referred to uh uh attachment number two there for the Franchise Tax. Uh where did you get the uh information contained on that uh attachment?

A. That uh was taken from the Annual Report of the bank and Farm Credit Administration.

Q. All right, sir. Now you in, in this computation of reduction in, of uh Franchise Taxes, you have used a figure of 5%. Now have you made some computation somewhere in, in this exhibit to arrive at that 5%?

A. Yes, sir, I have.

Q. And that, what, what attachment is that, Mr. O'Farrell?

A. That was attachment number three.

Q. Where did you get the information that you used in that, in that attachment?

A. I obtained that from the economic indicator prepared for the joint economic committee of the U.S. Congress.

By Mr. WARREN:

Q. If it please the Court please,

Q. Uh Mr. O'Farrell, you are being handed a copy, a book and what is that book entitled. I can't see it from here?

A. It's entitled, The 1967 Supplement to Economic Indicator.

Q. Can, is that, is that a publication from which you took the figures that appear on uh attachment number three to the—

A. I took all except the ones that have uh small crosses indicating the point.

Q. And uh where did you get the uh figures that uh you used that are represented by the small crosses?

143. A. The Secretary of the Treasury each year furnishes to the Farm Credit Administration a statement of the average interest rate paid on the public debt issue of the preceding year, and these small crosses on the chart were taken from the letter statements from the Secretary of the Treasury. They are made annually to the Farm Credit Administration.

Q. Referring back to the publication, the Economic Indicator, Mr. O'Farrell, can you point out to the Court if there is any special chart in that publication that uh you used specifically in coming up with your 5% interest rate—

A. The one that is designated as Table 33 on Page 121.

Q. All right, sir.

146 By the COURT:

I'll take judicial notice, it's so complex, I don't understand it. What discount figure do you use to get discount?

By the WITNESS:

Sir?

By the COURT:

What percent do you use to discount something to give you a present day value the payment of which is, say, deferred ten years?

By the WITNESS:

It depends on the risk involved. If it's something that's quite assured why you might use a going rate of interest. If it's something very risky, you might use a rate of interest like 12% which would be an interest rate which may be applicable to a poor second mortgage if you were buying it at that time.

By the COURT:

I was trying to find out what discount you used on—

147 By the WITNESS:

I used 12% on the first year.

By the COURT:

On the Year, 58?

By the WITNESS:

Yes sir.

By the COURT:

Did you use a different one for the other years?

By the WITNESS:

I used 10% for the second year, nine for the third, eight, seven, and six and I arrived at them in, you might say, a reverse order. I figured that at the end of six years you had enough experience that you were getting down to a normal interest rate. So taking 6% for the sixth year, I, working backwards, made a little higher interest rate discount for each of the preceding years because of the lack of historical prospective to project from.

By the COURT:

What is that, trigonometry that you employ?

By the WITNESS:

No sir.

By the COURT:

Is it higher calculus?

By the WITNESS:

148 Algebraic uh algebraic uh formula ordinarily is the basis of the uh compound interest.

By the COURT:

I've seen several books on it and after I got through examining them, I never have understood the formulas that they throw at you.

By the WITNESS:

Well the basic formula in discounting is the uh compound interest formula which is uh one dollar today predicted in the future would be one plus the interest rate raised to a power which is equivalent to the number of years in which you are determining the compound interest factor.

By the COURT:

All right.

By Mr. WARREN:

Q. Uh you have just gone through an explanation of Item Number E on your exhibit there, Mr. O'Farrell—

A. Yes sir.

Q. And uh you've got what looks to me to be a rather monstrous mathematical tool, or whatever you would prefer to call it; uh uh if this computation uh were not made uh at all and you said that that computation was used to show how the falling off of the Franchise Tax would shorten the period
149 of the payout for the A Stock, did you not, sir?

A. Yes sir.

Q. If you didn't, if you didn't even take that shortening into account, would that affect the result which you came to in any substantial way.

A. Uh not substantially.

Q. All right, sir. Will you proceed then on through your exhibit and tell us how you came to the conclusion that you did?

A. Uh this uh adjustment to the 28.6 years found in Line C above brings the years required to retire the Class A Stock down to 28.1 years. That's by applying this, uh these assumptions and reasoning that we find above it. In the Class B Stock, at that time, would be retired succeeding the Class A Stock but after the Class A Stock is retired, you would not only have a two hundred and twenty nine thousand eight hundred dollars that was available for retiring Class A Stock in 1958, but you would also have the Franchise Tax that is being expended in 1958 which, after the retirement of Class A Stock, would be added to the two hundred and twenty nine thousand eight hundred to get the amount each year that would be applicable to the retirement of the Class B Stock, and the Class C Stock

sub, subsequent. Now the two twenty nine eight hundred plus the fifty thousand hundred and one Franchise

150 Tax gives a total of two hundred and seventy nine thousand nine O one applicable each year to the retirement of the Class B Stock. In 1958, there was three hundred sixty thousand six hundred and sixty six dollars in principal amount of Class B Stock outstanding. Dividing that by two hundred and seventy nine thousand nine hundred and one, which is available each year for the retirement of stock, and gave a period of one and three tenths years for the retirement of Class B Stock. At that particular time, 1958, there was seven hundred thousand eight hundred and fifty of Class C Stock plus allocated surplus on the books of the New Orleans Bank. To retire that much stock at the rate previously given of three hundred and, of two hundred, pardon me, two hundred and seventy nine thousand nine hundred and one dollars per year, would take a period of two and a half years. So in retirement of the three classes of stock would require twenty eight and one tenth year for the A, one and three tenths year for the B, and two and a half years for the C. Adding them all together the total period to the, for the retirement of all this stock that were outstanding as of the end

151 of the year, 58, would have been thirty one and nine tenths years. As explained previously, in arriving at the

discount, this being the earliest year in which the retirement is being projected, I used a high risk interest rate of 12% for discounting back to obtain present value of the future retirement of the Class C Stock. The Class C Stock would be retired at a hundred dollars a share but it would not be retired for thirty one and nine tenths years. So discounting back thirty one and nine tenths years at a rate of 12% means that each dollar that you are considering, thirty one and nine tenths years from now, has a present value today of point 0 2 6 9, which is 2, uh 2 point 6 9 cents for every dollars. As indicated on the attachment number two, each share of Class C Stock had associated with it 27% of its face amount in allocated surplus. So for each share of Class C Stock that would be retired, there would be 27% of as much in allocated surplus. So instead of retiring a one dollar Class C Stock thirty one and nine tenths years from this date, the owner would be obtaining the retirement of a Class C Stock plus it's associated allocated surplus which would increase the amount that he would receive by 27%. So taking this factor of 2 point 69 cents per dollar that would be received on 152 the retirement and multiplying it by one point 27 to make allowance for the allocated surplus that would be associated in the retirement, the factor is increased to three point four two cents for each dollar; and for each hundred dollar face amount of Class C Stock, the present value would be three dollars and forty two cents, or a hundred times three point four two cents.

By Mr. WARREN:

Q. Now that, you've gone through the Year, 1958, have you not, Mr. O'Farrell?

A. Yes sir.

Q. Well, did you make a similar computation for the other years?

A. I did.

Q. And where is that computation to be found?

A. It is shown on attachment number four.

Q. Will you explain to the Court what attachment number four is?

A. Attachment number four, without having all the details is set up in exactly the same order as the first sheet, which I made the explanation, A, B, C, D, E, and the first column in that

uh attachment number four has the same resulting figures that are shown on the previous sheet that has a ten at the top of it.

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By Mr. SATTERFIELD:

May it please the Court, now that the explanation has been made of the basis of this calculation, we object to this testimony and move to exclude that heretofore given on the grounds, first, that it is totally inapplicable to Class C Stock of the New Orleans Bank for Cooperatives as has been shown and described in the stipulation of evidence. Second, that they uh omit from it all pertinent factors having to do with the determination of the time within which retirement may be made other than the one factor of the amount that was retired during that one year. Third, it omits therefrom uh the elements which are required to be considered under the regulations of the Internal Revenue Service being, as described in Revenue Ruling Number 50 dash 60 applicable to stocks of this kind and uh also, that it has not been shown that any of the, has not been shown that the results here arrived at have any true relation to a fair market value, nor to a true uh or actual value for any purpose of the stock here involved. And further grounds, it's immaterial, incompetent and irrelevant. We will point out some six or seven of the items which have been omitted during cross examination unless the Court would like to have them

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at this time.

By the COURT:

I'll overrule your objection. I think you are talking about weight to be assigned to the evidence, not incompetence and I'll overrule your objection.

By Mr. SATTERFIELD:

May it please the Court, would it be appropriate uh in order to save time of the Court that it may be considered that this objection applies to all testimony by this witness?

By the COURT:

Well I don't know that it would apply to all of it. I don't know what his further testimony will be. That would be my ruling if it's the same situation as is now before me.

By Mr. SATTERFIELD:

Thank you, sir.

By Mr. WARREN:

Q. Mr. O'Farrell, will you briefly explain to the Court what attachment number five—

By the COURT REPORTER:

You are dropping your voice and I can't understand what you are saying.

By Mr. WARREN:

All right.

155 Q. Will you please explain to the Court what the meaning of attachment number five to the exhibit is?

A. This is a graphing of the data that's given from the first explained sheet headed ten, and what is given on the attachment number four, and it is intended to originally show this is a straight line retirement projection except that when you get down to a period of three, four, or five years from the time the Class A Stock is retired because of the effect of the, because of the effect of the Franchise Tax, you have another rate of retirement from then on, and that's shown by the little uh duplication of lines down near the vertical line that goes up near the middle of the page. It's more or less a refinement to illustrate how the development was made. It isn't essential to the development but it's explanatory in a graphical manner.

Q. Mr. O'Farrell, uhh your testimony as to value, it appears is predicated in large measure upon a predictable uh retirement date for A Stock. Is that true?

A. I, I estimated the retirement date for each of the stocks I thought it was predictable.

Q. Uh why, why, why did you uh think that the retirement of the A Stock was predictable?

156 A. Because it was permitted by law when the Class A Stock was retired, the cooperatives would be in relatively complete charge of the Bank for Cooperatives, so it would have been to their self-interest to have retired this stock, so I thought it would be normal to assume that they would retire it and also, it was part of the policy of the bank, of the Bank for Cooperatives—

By Mr. SATTERFIELD:

Object to the testimony of this witness as to any policy of the Bank for Cooperatives or self-interest. He is not qualified as an expert on the self-interest or policies of the Banks for Cooperatives of the United States or other banks either.

By the COURT:

I understand him to simply be talking about what he took into consideration. I don't think he's trying to establish any policies. Overrule the objection.

By Mr. WARREN:

Q. What, when you say it would have been in the self-interest of borrowers to retire the uh Class A Stock so that the C Stock could be retired, uh what do you mean by self-interest, Mr. O'Farrell?

A. The owners of the Class C Stock were the cooperatives. The cooperatives would be in, as I said, relatively free
157 to operate the bank after the Class A Stock is retired. The Class C Stock didn't pay them any return annually. The only way they could get their money back out of Class C Stock was to retire it. They would have in their hands the power to retire it, it would be to their advantage to retire it, and it is logical to assume that they would retire it.

Q. Uhh why do you say it would be to their advantage to retire it?

A. Because they would be getting cash for something that was giving them no return.

Q. Now you said, I believe, that in addition to this self-interest figure, that it was, it was the policy—

A. Policy of the Bank for Cooperatives.

Q. To do what?

A. To retire the Class B and the Class C Stock in rotation after the Class A Stock is retired.

By the COURT:

160 This was marked for identification, D-5. Do you make an objection to that?

By Mr. SATTERFIELD:

May it please the Court, we object to the introduction of this on the same grounds that we objected, and moved to exclude the evidence as to the first page thereof and on the
161 further ground that the witness has not, in any manner, testified concerning, verified, or uh given evidence which would support the compilations affecting any years other than the year ending on June 30th, 1958, whereas the attachment number four reports with varying factors involved to affect the years ending June 30th, 59 through 63 inclusive. The witness has not verified or testified concerning those matters and such evidence has not been sustained in any way.

By Mr. WARREN:

If the Court please, uh I asked the witness uh after he had run through the front page, that is, the page marked ten at the top, after he had gone through that page, I asked him if that computation related to the Year, 1958, and he said it did, as I recall. I then asked him to uh if he had made a similar computation uh for the Years, 1959, 60, 61, 62, and 63 and uh I believe that his statement was that he used figures shown on attachment number four in the very same manner that he had uh used the figures uh on, on the first page. He just jacked those, took the figures out that are on page ten and put these uh other figures in.

By the COURT:

162 I'll overrule the objection and let it be marked the same corresponding number, in evidence.

(Marked for identification now entered into evidence and marked as Defendant's Exhibit No. D-5.)

By Mr. WARREN:

Your witness, Mr. Satterfield.

CROSS EXAMINATION

By Mr. SATTERFIELD:

Q. Mr. O'Farrell, in uh arriving at these uh computations or calculations which you have made, I believe that you stated that these have not been related by you to any known sales upon the market, or any known sales of the C Stock of the New Orleans Bank for Cooperatives. Is that not correct?

A. I didn't have knowledge of any sales that were comparable in that period.

Q. Then your answer to my question would be yes, isn't it? Is that correct, sir?

A. No answer.

Q. You'll have to answer out loud so they can hear you.

A. No answer.

Q. Your answer would be yes?

A. Yes sir.

162 Q. Thank you. Now, there of course, are different types of uh corporations that are involved in the financial fields in the United States and in connection with

the evaluation of the different types of securities of corporations for investment or other purposes when there are not available any sales known upon the market place, uh what is the nature of the type of corporation that is referred to in financial parliament where that is not available but, nevertheless, securities are being valued for state tax purposes, gift tax purposes, or any valuation purpose. What are they generally called?

A. I don't know whether you are referring to comparable sales or not.

Q. No, no comparable sales. I am referring to those where you do not have a history or knowledge of sales. What term is used to refer to that type of corporation?

A. One of them is closely held corporation.

Q. Then that would apply, that is what would apply to this case, would it not?

A. Uh not necessarily. It is a corporation in which the securities were not marketed but I am not certain that it would technically be called a closely held corporation.

Q. Generally speaking though because of it's nature and being compared to those where market sales are held, it
163 would generally fall within that classification for valuation purposes, would it not?

A. I, I think in each instance you have to consider your corporation separate in the light of the facts that are available, but I would say that the analyst would probably investigate it the way he would investigate a closely held corporation stock and he might investigate in some other manners also.

Q. But he would investigate it the way he would investigate stock in a closely held corporation, would he not? Including further investigations of further factors. Is that not right?

A. He could very well do it if he wished but he needn't necessarily be confined to that type of investigation.

Q. But that would be a correct method of analysis, would it not, Mr. O'Farrell?

A. It would be one tool he could use.

Q. Yes sir. Now uh as a matter of, you stated that one of the elements which you considered in arriving at the valuations here was that uh of general economic conditions and also the financial history of uh financial, I guess the word is history of corporations and businesses in the United States. And then you also have referred to using that in connection

164 with value. When you refer to the economic conditions, you are referring, are you not, both to the actual conditions of business and to the value of a dollar as reflected by its use in the financial world and otherwise in the United States?

A. Yes sir, all the different factors that affect the economic life of the country.

Q. And, of course, one that affects us all is the varying value of the dollar from time to time in the United States. Is that not correct?

A. That's one of them.

Q. Now then uh is it not true that uh in the uhh in determining the value, oh, excuse me. Uh I believe you testified to begin with, did you not, that your calculations here were made to determine and did reflect the fair market value of Class C Stock of the New Orleans Bank for Cooperatives?

A. Yes sir.

Q. And uh then it is not a compilation which is attempting to reflect what might be called the general value or the uh basic valuation for business purposes other than market but is a calculation to arrive at fair market value. Correct?

A. Fair market value only.

Q. Now in your calculation, in your calculation, in 165 each of the years involved, if you will turn, and may I inquire the number of this exhibit?

By the CLERK:

Which one? D-5.

By Mr. SATTERFIELD:

Exhibit 5.

By the CLERK:

D-5.

By Mr. SATTERFIELD:

Q. Exhibit D-5, you have included in each compilation affecting each year a factor which is referred to on the first page of Exhibit D-5 as the ratio of Class C Stock issued plus surplus allocated year ending 6-30-58, Class C Stock alone, attachment two, varying, of course, from year to year as that relationship varied. Has that not been concluded?

A. Yes sir.

Q. Now you are, you have been with the Internal Revenue Service how long?

A. A little over eight years.

Q. A little over eight years. You are familiar with the fact that an examination by an Agent at the District level as a result thereof he will frequently propose deficiencies?

A. I am familiar that they make uh examinations at 166 that level. I don't know of anything else concerning your question. I mean that's uh—

Q. Are you familiar with the fact that in these cases that there was not any proposed deficiency in relation to the allocated surplus or the amount involved therein or the dollars involved therein?

A. I'm not uh, I wasn't interested in the tax consequences. All I was trying to do was define what would be obtained at the end of this period by the holder of the stock and to obtain that, I had to make allowance for the allocated surplus which was in the policy and practices of the bank associated with the C Stock.

Q. You heard the testimony yesterday that, that insofar as allocated surplus was, uh the President of this bank was concerned, that it is the first source after the current earnings and reserve for losses to which resort would be made in case of necessity and that they have never notified any of their patrons of the allocation of any surplus to them, did you not?

A. I don't uh remember in the words you've used, the testimony but I don't take exception to it because as far as I remember, it was along that line.

Q. Also having been preparing yourself for testimony in this case, you are familiar, are you not, with the fact that in 167 all of the amounts involved as affected by the pleadings, and all other documents, the claim for refund and all other matters herein, that the number of dollars reflecting the allocated surplus is not involved in any issue or any pleadings in this case. Are you not familiar with that?—

By Mr. WARREN:

I object, Your Honor. He has asked the witness uhh a question concerning all the records and pleadings involved in this case and has not specified if he wants to specify what papers he's talking about, he ought to tell the witness what he's talking about so that he can be responsive.

By the Court:

I think you better rephrase your question. There are very few witnesses who know anything about pleadings.

By Mr. SATTERFIELD:

Q. Now, Mr. O'Farrell, in preparing to testify, after eight years of testimony for the Internal Revenue Service uh in matters of this kind, did you familiarize yourself at all with the complaint filed in those two cases in this Court?

A. I didn't do it in enough detail that I can say what is in the pleadings.

168 Q. You did familiarize yourself with it generally, did you not?

A. Not, not in enough detail that I could be quizzed on them.

Q. Did you uh read them at all?

A. I read some of them.

Q. Did you read the complaints in these two cases?

A. Not in full.

Q. Which portion did you read?

A. I don't remember. It was several months ago and so I can't tell which. I am particularly interested in the papers from their effect on the valuation on something that I'm not interested in the legal argument unless it affects the valuation. I'm not interested in a lot of the other factors unless they affect evaluation, so with the mass of papers that are available, the appraisal has to be somewhat selective.

Q. Then you did read that portion of the complaints that had to do with the dollars involved and the evaluation of the amounts involved, did you not?

By Mr. WARREN:

I object, Your Honor. The witness has stated that he didn't recall at this point in time what he had read in those complaints.

169 By the COURT:

Well, I'll let him answer. Overrule your objection. Go along.

By Mr. SATTERFIELD:

Q. Would you answer, please sir?

A. I did read the, you say I did read the—

Q. Portion of the complaints which had to do with the number of dollars involved and would affect the valuation of the amounts of stock here involved.

A. I don't remember the amounts in money but but I read concerning the amount in deficiency in the, uh in the issue between the Government and the uh Plaintiff of the uh on the money involved in it.

Q. You also read that similar portion for the claim for refund which was attached to the complaint as a part of the Government file, did you not?

A. I may have. I don't remember.

Q. Is it the best of your recollection that you did?

A. I, I don't know that I did.

Q. Well now as a matter of fact, uh Mr. O'Farrell, by this somewhat circum, circumlocution, uh you have brought into this case as a part of the issues in this case, uh every dollar as shown by attachment number two of Exhibit D-5, every dollar which was uh allocated surplus to uhh the uh patrons for 170 the years involved, have you not?

A. Yes sir.

Q. And by so doing, if the Government was to recover upon the basis of your report, it would require the payment of tax not only upon the C Stock involved but also upon the, not only upon the valuation of the C Stock involved, as you calculated it, but also upon the valuation of the allocated surplus, as you calculate it, would it not?

By Mr. WARREN:

I object, Your Honor, he's asking the witness to make a legal conclusion on the, based on recovery. This witness has testified with respect to his opinion as to the value of this subject stock on particular dates. What the Government is going to recover, or, or what the taxpayer is going to recover or not recover, he's not testified with respect to it and neither has he, he uh, he's not been held out as an expert in the field of recomputation of taxes and uh I feel, therefore, it's an improper question and object to it.

By the COURT:

He's on cross examination. If he knows, he may answer.

By Mr. SATTERFIELD:

171 Q. Would you answer the question, please sir?

A. I've forgotten the question. You'll have to repeat it.

By Mr. SATTERFIELD:

Could you read the question to the witness?

By the COURT REPORTER:

Yes sir. It's about a half a page long. And by so doing, if the Government was to recover upon the basis of your report, it

would require the payment of tax not only upon the C Stock involved but also upon the, not only upon the valuation of the C Stock involved as you calculated it, but also upon the valuation of the allocated surplus as you calculated it, would it not?

By Mr. SATTERFIELD:

Q. Would you answer the question now, please sir?

By Mr. WARREN:

I would like to interpose another objection; he has stated, the question is if the Government were to recover. The Government does not seek to recover here. It's, it's the taxpayer who seeks to recover.

By Mr. SATTERFIELD:

May I say if the Government were to win the case?

By the COURT:

I understand. Overrule the objection.

172 By Mr. SATTERFIELD:

Q. Would you answer it, please sir?

By the COURT:

You may answer.

By the WITNESS:

The value of the C Stock, at the time which I appraised it, was associated with the allocated surplus at that time, and if a tax is applied to the C Stock at the time I appraised it based on the values that I estimated for it, the tax would also be on allocated surplus. That is all I can say for it. I took it into consideration when I appraised the C Stock, so if the tax is on the basis of what was in it when I appraised it, there would be a tax on the allocated surplus.

By Mr. SATTERFIELD:

Q. Then uh referring to the first page of Exhibit D-1; uh if there is before the Court only issues as to the C Stock involved, the valuations which you have placed on that issued in 1958, as of June the 30th, 1958, of three dollars and forty two cents uh would not be a correct valuation of the C Stock alone, would it, as distinguished from the allocated surplus?

By Mr. WARREN:

173 I object, Your Honor. I don't understand the question and I don't believe that the witness can understand it.

By the COURT:

Well, we'll let the witness say whether or not he understands it. If he don't, you may ask for clarification. Otherwise, overrule. Go along.

By Mr. SATTERFIELD:

Q. Mr. O'Farrell, what is your answer, please sir?

A. Will you have the question read?

Q. I'll re-state it for you. Is it not a fact that turning to page one of Exhibit D-5, and turning to the figure at the bottom thereof, three dollars and forty two cents which uh is there stated as the fair market value of the Class C Stock, and so forth, if that the, if that were limited to the fair market value of Class C Stock as distinguished from allocated surplus, it would not be three dollars and forty two cents, but would be a lesser amount, would it not?

A. It wouldn't be fair market value of C Stock if it was changed from what it is here, according to my estimate.

Q. Your answer to my question this is yes, it is not? I
174 would like you to answer the question yes or no and then explain, please sir. Be glad to read the question to you again if you can't answer it now. Would your answer be yes subject to explanation made?

A. I would like to have the question read again and I'll be sure.

By the COURT REPORTER:

Is it not a fact that turning to page one of the Exhibit 5, and turning to the figure at the bottom thereof, three dollars and forty two cents which is there stated as the fair market value of the Class C Stock, and so forth, that if that, that if that were limited to the fair market value of Class C Stock as distinguished from allocated surplus, it would not be three dollars and forty two cents but would be a lesser amount, would it not?

By Mr. SATTERFIELD:

You may answer and——

By Mr. WARREN:

Your Honor, I would——

By Mr. SATTERFIELD:

Q. Explain later:

By Mr. WARREN:

I would object to that. The question is, is it not a fact,
175 a long statement and so forth, and then he says, is it not

true? The witness can't possibly answer a question like that with uh; and, and it be meaningful, If he says yes, we can load into that, and so forth, anything we want to. So I object to it. I don't think the question is a meaningful question and can be answered or is subject to an answer.

By the COURT:

Let him answer if he can.

By Mr. SATTERFIELD:

Q. Your answer would be yes, would it not, subject to the explanation you gave a moment ago?

A. The three forty two is my estimate of the fair market value of the Class C Stock.

Q. Would the answer to my question be yes or no, please sir?

A. And it contained all elements that made up the fair market value.

Q. I repeat my question, Mr. O'Farrell, and ask you to respond yes or no, and then explain. Is it not a fact that if the valuation utilized in connection with uh Class C Stock for the year ending June 30th, 1958 as calculated on page one of Exhibit D-5 was limited to a valuation of Class C Stock as distinguished from, and not including, allocated surplus, 176 then the amount of three dollars and forty two cents would be reduced substantially. Is that not true? Would you answer yes or no and then explain?

A. If you could make that kind of appraisal and get a, something that would be useful, it would be less.

Q. It would be less. Thank you, sir. Now would you turn, please, to your attachment number four and I refer you now to the last line of figures beginning with uh the column headed, June 30th, 1958, the line being designated, Q, and I refer you to the number of dollars appearing in, with reference to succeeding years as therein shown; being seven dollars and fifty cents for the year ending June 30th, 1959; fourteen dollars and thirteen cents for such year ending 1960; twenty four dollars and sixty five cents uh for the fiscal year thus ending in 61; twenty nine dollars and sixty cents for the fiscal year thus ending in 1962; and thirty eight dollars and sixty five cents for such fiscal year thus ending in 1963. Is it not true that the testimony which you have just given concerning the year ending June 30th, 1958 related to the figure of three dollars and

forty two cents likewise applies to each of these figures or valuations for each of these years?

Q. To be sure that I understand what we're talking about, it wouldn't be appraisal of C Stock but it would be less.

Q. Well, you say it wouldn't be appraisal of C Stock, you mean that if you include in the C Stock the allocated surplus, do you not?

A. The allocated surplus is part of the value element in C Stock.

Q. Would you answer my question, please sir. My question is, what you are saying is that it would be, that it would be appraisal of C Stock if you included in C Stock the amount of all, allocated surplus. Is that not true? Please answer for the record.

A. The appraised value of C Stock includes allocated surplus, yes.

Q. Your appraised value of C Stock includes allocated surplus?

A. That's right.

Q. And that is true for each of the years?

A. Yes sir.

Q. Now, Mr. O'Farrell, as an analyst of values, when it is shown as it is shown in this case by testimony and stipulation that there has been no notification whatsoever to the borrower of the existence of this allocated surplus, that there has been no type or form of Class C Stock utilized in connection with the allocated surplus, when it's been testified it would be first resorted to subject to matters I mentioned a moment ago, in case of losses and it may be disposed of differently or separately, may be, may be treated differently or separately by the bank as shown by the stipulation and testimony herein, would you tell this Court that even if it were proper to include it under the pleadings that in your opinion the allocated surplus has the identical value of C Stock?

A. I haven't said that the allocated surplus had the identical value as the C Stock.

Q. Beg pardon?

A. I haven't said that the allocated surplus had an identical value with the C Stock.

Q. You have used identical dollars in reaching your calculations, have you taken the number of dollars allocated surplus each year, the number of dollars of C Stock each year and placed them together for all purposes of calculation? Would you answer yes or no and then explain?

A. I have been uh—

Q. Would you answer yes or no and then explain?

A. I have added the allocated surplus to the C Stock.

179 Q. Both at the number of dollars shown on the uh records that are in the case, have you not?

A. In determining the present value of the C Stock.

Q. I see. Thank you, sir. Now would you please turn to page four of uh attachment four, I'm sorry, of Exhibit D-5 and do I understand your testimony to be to this Court that in your opinion as an evaluation analyst that the value of C stock for allocated by the New Orleans Bank for Cooperatives within the period of, the period of seven years has increased as to the stock issued in such year, eleven times or eleven hundred percent—

By Mr. WARREN:

May it please—

By Mr. SATTERFIELD:

To be from three dollars and forty two cents to thirty eight dollars and sixty five cents?

By Mr. WARREN:

I object, Your Honor. Counsel has asked the witness if he, Counsel, understands, and this witness can't say what Mr. Satterfield understands.

By the COURT:

I'll overrule your objection. I think he understands the question. Go along.

By Mr. SATTERFIELD:

180 Q. Would you answer the question?

A. On the basis of the present value of a dollar in the different periods, the amounts have increased from three dollars and forty two cents to thirty eight point sixty five cents which is at least more than ten times as much.

Q. Based upon the present value of a dollar, that which may be reflected by certain indices, is that not true?

A. This is based on the uh factors that were reported by the banks at that particular time.

By Mr. SATTERFIELD:

May I see the exhibit which is the Economic Indices? It's the yellow book there. If the Court will indulge me just one moment.

By Mr. WARREN:

If—

By Mr. SATTERFIELD:

May I inquire the number of the exhibit from you, please sir?

By the MARSHAL:

D-6, identification.

By Mr. SATTERFIELD:

Q. Would you please turn to page seven of Exhibit D-6 referred to as Economic Indices—

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By the COURT:

That's not in evidence, Mr. Satterfield. That's the one that they picked out page one twenty one to offer in evidence, so if you want to put it in evidence, you may use it but it hasn't been even offered as yet.

By Mr. SATTERFIELD:

I will ask that it be uh marked for identification at this time. We will offer it at a later time.

By the COURT:

All right, what page is that?

By Mr. SATTERFIELD:

May I ask that uh the Clerk mark page seven of this document for identification at this time?

By Mr. WARREN:

If it please the Court, if Counsel would like, I will join him in a joint stipulation that the entire uh publication may be made part of the record for whatever purpose that uh we may want to use it.

By Mr. SATTERFIELD:

Please the Court, I believe it would burden the record.

By the COURT:

I feel like it's the trial Court's duty to keep a record
182 down within permissive ranges and I don't think it would be proper to send the whole book in at all but I now let page seven be marked for identification for the Plaintiffs. I give you the same privilege I gave the Defendant, that is, to add any other pages that are necessary to be added so that we don't get so many pages in there that nobody is going to read them.

By Mr. SATTERFIELD:

Thank you, sir.

By the COURT:

Might as well be realistic about this thing. You give the Judges a big stack of books and I can tell you they're not going to read it.

By Mr. SATTERFIELD:

Thank you, sir.

(Marked for identification as Plaintiff's Exhibit No. P-5).

By Mr. SATTERFIELD:

Could you give me the number of the exhibit marked for identification?

By the CLERK:

P-5.

By Mr. SATTERFIELD:

P-5.

183 Q. Uh turn to exhibit P-5, you find there, do you not, that the value of the dollar as reflected by this publication in 1958 was placed at a hundred percent, was it not, or dollar for dollar, right? That is the base point for this publication?

A. That is the price defective, uh used in this tabulation, yes sir.

Q. And uh between that date and uh 1963, 58 to 1963, uh there had been a reduction of the value of the dollar to the extent that the dollar, as of 1958, it would take a dollar and a hundred, a hundred dollars as of 1958, it would take a hundred and seven point two dollars to purchase the same amount of goods in the United States, or there was that variation in the value of the dollar, was there not?

A. Yes sir, according to the table.

Q. That is a difference of a total of some seven percent reduction in the value of the dollar, not exactly but almost. Right?

A. Close, close to that, close to that.

Q. Now uh in your, by the way, while you have that before you, would you turn uh back to the year which was utilized in your attachment number three concerning the upward trend of uh interest rates and in that connection, turn to the Year, 1946. And what was the index that year of the value. I mean of the value of a dollar as compared to 1958? That's on
184 page seven being the exhibit that I just referred to.

By the COURT:

What number?

By the CLERK:

P-5 for identification.

By Mr. SATTERFIELD:

P-5:

By the WITNESS:

Sixty six point seven.

By Mr. SATTERFIELD:

Q. Sixty six point seven. And then the value of the dollar decreased so that in 1958, it took one dollar to purchase goods and service in the United States which in 1946 could have been purchased by sixty six and two third's cents. Isn't that true?

A. Yes sir.

Q. Or devaluation of approximately one third or a little more depending on how you apply it from the beginning to the end uh backward, is that not right?

A. Yes sir.

Q. Now you have made these calculations, have you not, based upon the uh factors shown on page, or attachment number four as explained by the first page of your Exhibit D, the explanation on page one of Exhibit D in applying to each of the years shown on attachment four. Isn't that right?

185 A. Yes sir.

Q. Now I, reference was made yesterday to the fact that uh when there was set up a goal or plan of the retiring of A Stock by the New Orleans Bank for Cooperatives about uh 1957 or 8, I believe it was, or thereabouts, that the bank had been in business since 1933 or more than twenty years, of course, subject to the amendment of 1955, and you were familiar and are familiar with the fact, are you not, that uh these banks have been in existence since the Farm Credit Act of 1933 subject to the several amendments which have been thereafter adopted?

A. Yes sir.

Q. Now you have adopted as the percentage utilized in the discounting of the value of money for the Year, 1958, uh the uh percentage of twelve percent at the time when the bank had been in existence and had experience in the banking field for twenty five years, I believe you testified that percentage is a

correct percentage and you have so utilized it in this uh uh presentation and analysis, have you not?

A. Yes sir.

Q. Then that percentage itself nor any of the succeeding percentages are not of themselves related to any of the other
186 factors involved which are set forth on this page, are they? They are simply chosen by you as your thought of a correct percentage?

A. Yes sir.

Q. All right.

A. Yes sir.

Q. Now would you please, we have here handed to Counsel a publication known as Stanford Research Institute Growth Factors which actually is simply a discount table or compound interest table. Would you please turn to attachment number four of uh Exhibit D-5 to the Year, 1963, and without changing any other factors, would you please utilize twelve percent as the percentage as utilized on line M instead of six percent, and then advise us what the uh result would be in line N which is described as the present value of one dollar at M rate of interest one number of years?

A. I'm not familiar with this tabulation. I have one of my own here by, used by the Agricultural Department that uh covers the same—

Q. If I may see it very briefly—

A. And probably save time.

By Mr. SATTERFIELD:

Just take a moment, may it please the Court.

Q. I will rephrase my question. Uh using a proper
187 table reflecting the factors here involved, would you apply the item of twelve percent instead of the item of six percent to the figures shown in the last column on attachment four of Exhibit D-5 being for the year ending June 30th, 1963, and tell us what would be the result instead of the point three 0 six five now appearing in line N?

A. Without checking, I'd say twelve dollars and sixty five cents.

Q. Beg pardon?

A. Without checking it, I'd say twelve dollars and sixty five cents.

Q. Is it not a fact that it would be seven dollars and seventy six cents? Would you check that again, please sir? I mean review your study there?

A. I still have twelve dollars and sixty five cents.

Q. Beg pardon?

A. I still have twelve dollars and sixty five cents.

Q. Would you say that again, sir, I didn't hear it?

A. I still have twelve dollars and sixty five cents.

Q. I see. Now that is in lieu of which figure?

A. Uh thirty eight dollars and sixty five cents.

Q. That was not my question, uh Mr. O'Farrell. I asked you to apply it to line M the figure being thirty dollars and sixty five cents, not to line P, which I did not mention to you.

188 I'm asking you to apply it to the figure representing C Stock without the, including therein your opinion of some value of allocated surplus, then would you please—

A. Ten dollars and four cents.

Q. Ten dollars and four cents. Now would you please uh also apply the twelve percent to the figures in the column for the Year, 1962, and give us the results insofar as line N is concerned, that being as described in my former question.

A. Eight dollars and thirty six cents.

Q. Eight dollars and thirty six cents.

A. Yes sir.

Q. Would you do the same, please sir, for the same line as to 1961?

By Mr. WARREN:

What line are you talking about, Mr. Satterfield?

By Mr. SATTERFIELD:

Line N I referred to. I'll be glad to do it each time.

Q. I'm referring to line N as it results, I'm referring to the application of the percentage shown, application of or a percentage of twelve percent in lieu of the percentage shown in the column. What would be the result, please sir, as to 1961?

189 A. Eight forty six.

Q. Similarly apply it to the column representing June 30th, 1960?

A. Five eighty two.

Q. Five dollars eighty two cents. Okay, sir. As to the one involving 1959?

A. Three forty six.

Q. Then as a matter of fact, Mr. O'Farrell, uh if we do not include the allocated surplus and if we apply the factor of twelve percent that you applied to the year ending June 30th, 1958 as uh the proper factor, then the valuation of the Class C Stock would be in the number of dollars per share you have stated upon the assumption that I have stated, would it not?

A. On the assumption that what, sir?

Q. On the assumption that I have stated. That is, the application of this of this twelve percent and the disregarding of any alleged value of allocated surplus, it would be these results, would it not?

A. On the twelve percent discount, it would be the figures that I have given you, yes.

Q. Yes sir. Now, Mr. O'Farrell, are you familiar with the compilation, a copy of which you kindly handed to Mr. uh Verlander this morning, I believe, which is referred to 190 as rates of Return on Investments of Common Stock 1926 to 1965, sponsored by Merrill, Lynch, Pierce, Fenner and Smith, Incorporated, the pamphlet which you handed Mr. Verlander being an excerpt from the full compilation entitled, quote: Rates of Return on Investments in Common Stock; year by year record 1926 to 1965?

A. Yes sir.

Q. Is that considered authoritative in the financial field?

A. Not necessarily authoritative. It's another uh—

Q. Beg pardon?

A. It's a study of the, of the growth factors in the equities on the New York Stock Exchange.

Q. Is it not considered to be a reliable study, one that may be considered in arriving at the valuation of stock and the results in connection therewith?

A. As far as I know, it's authoritative for what it purports to be which is a uh statistical analysis.

Q. Thank you, sir.

Would you hand this to the Judge and opposing Counsel? Will you hand this to the witness? Excuse me, may I uh hand him one?

Q. You are handed a document there; is that not the document which uh you handed to Mr. Verlander this morning or some, recently?

191 A. One like it, at least.

Q. In other words, it's identical with the one if it is not the one, correct?

A. As far as I know, it is.

Q. Yes, sir. Uh now that is an extract, as I stated, from the preparation of Merrill, Lynch, Pierce, Fenner and Smith, Incorporated to which we referred in the last few questions, is it not?

A. Yes, sir.

Q. Now, in returns, rates of return in an investment in common stocks listed on the New York Stock Exchange with re-investment of dividends percent per annum compounded annually for the one question to symbolize tax exempt. Now would you please refer to that and uh taking uh the period, let's see just one second, from 19 uhh 58 to 1963, what returns do you find?

A. Eight and seven tenths percent.

Q. Now the period uh, let's begin with uh 1958 uh taking the period uh ending in December 1958 and beginning, say 1946. What do you find?

A. Fifteen and two tenths percent.

Q. And taking the next year on the same basis, what do you find? 59.

A. Fifteen and three tenths percent.

Q. And the following year on the same basis, what 192 do you find?

A. Fourteen point 0.

Q. I see. And that year, which year was that in? Which year was that?

A. That was 1960.

Q. 60. Now 19 uh, you have, what, the next year, the one which would be 59, would it not? Which would be the next year that you have calculated?

A. 1961.

Q. 1961, what do you find?

A. Fourteen, nine.

Q. In 1962?

A. Twelve point eight.

Q. 1963?

A. Thirteen point two.

Q. Now, Mr. O'Farrell, those take into consideration, do they not, uh the various factors which uh are considered in arriv-

ing at the fair market value of stocks, including but not limited to the growth factor, the return factor and the earnings to price factor. Isn't that correct?

A. I would assume it would. I don't know.

Q. That is your assumption and belief, is it not?

A. I assume they do, yes.

Q. Yes sir. Now then, if those particular percentages 193 were applied in lieu of percentages which you have used on line M of attachment four to exhibit D-5 with one exception they would exceed twelve percent and would, therefore, reduce the valuation of the stock below that to which you testified a moment ago, would they not?

A. If the figures that you have taken here for 1946 were applied, they would change the figures and all of them down there, I believe.

Q. Now would you turn, please, to uh, that's right. Now in making your calculation, I believe you stated it was based upon the value of uh money and was calculated upon the assumptions that the one hundred dollars, or the par value, would be returned in the number of years which you have calculated upon the assumption you've stated. Isn't that correct?

A. Yes sir.

Q. Now when it comes to U.S. Government Bonds, or as you referred to here in attachment number three to your uh Exhibit D-5, they are definitely payable in full on a day certain and are guaranteed by or upon the pledge of the United States of America, are they not?

A. No answer.

Q. Sir?

194 A. That was in there, yes sir.

Q. Now you had mentioned that uh, one of the basic assumptions you had made was that first, after the A Stock had been revolved out that the New Orleans Bank for Cooperatives would then be under the control of the stockholders. Are you not familiar with the fact, as shown by the stipulation in this case, that when the Class A Stocks of the New Orleans Bank for Cooperatives is revolved out, that the New Orleans Bank for Cooperatives will still be governed by the same board of directors as to which the stockholders can elect or nominate only two out of seven, and that their actions

of this nature are all, and then will still under the statute all be subject to the approval of the Farm Credit Administration?

By Mr. WARREN:

I object, Your Honor, I don't think the stipulation says what Counsel says it does.

By Mr. SATTERFIELD:

May it please the Court, we have attached uh the copies of all matters, may I say the stipulation, and the Statute of the United States so provided and I think Counsel will not object on that ground.

Q. What is your answer. I amended it to say stipulation and statute—

195 By the COURT:

I couldn't pass on what your stipulation shows. If you gentlemen don't know, I certainly don't. Not now, I will know. I'll let him answer.

By Mr. SATTERFIELD:

Q. What's your answer, sir?

A. No answer.

Q. What is the answer?

A. I don't know that.

Q. You don't know that, therefore, your assumption has been, as you stated a while ago?

A. No answer.

Q. Thank you, sir. Now is it not a fact or do you, in your assumption, did you know that uh no one is permitted to vote a share of stock even for the two directors unless they have borrowed from the New Orleans Bank for Cooperatives uh within the preceding two years or then prior to the time of voting?

A. I believe that's correct.

Q. Then is it not a fact that if at, if the Farm Credit Administration and the Farm Credit Board of this district did not control the bank but if it were controlled by the C Stockholders, it would be to the interest of the patrons in 1971 who contributed margins through their borrowing of money, to pay themselves in cash rather than to pay cash on C Stock that somebody else obtained in 1958. Would that not be to their self-interest?

A. If someone else had obtained the stock in 1958 were voting didn't have the stock prior to the time to which they were voting, I would say it would be to their advantage to pay it to themselves at that particular time.

Q. Then if the patrons of the bank twenty point three years later as applied to the stock issued 1963 were different from the patrons of the bank and C Stock holders in 1963, then those patrons and stockholders twenty years later self-interest would be served by voting to pay the patronage refunds in cash instead of resolving the old C Stock, would it not?

A. No answer.

Q. Is that correct, sir?

A. If there were different parties, it would be to their advantage to pay to themselves rather than somebody else, I agree with that. It's a little involved for me to answer yes or no.

Q. Then, Mr. O'Farrell, that same answer and situation would apply, would it not, to stock as affecting stock issued in 1958 where the determination of whether the cash would be paid on C Stock for the then year or the 1958 year was made by stockholders thirty one point nine years after June the 30th, 1958.

By Mr. WARREN:

I object, Your Honor, Counsel has asked the witness about four or five different questions in one sentence, it seems to me.

By the COURT:

Well I think it's objectionable for another reason. I think you're just pumping arguments through the witness, and I'll sustain the objection. These are arguments, that's not questions.

By Mr. SATTERFIELD:

May it please the Court, the only reason, may I explain, for asking it was, the witness testified it would be to the selfish interest of the stockholders to revolve out the C Stock and as a matter of fact, now, he is not testifying under the circumstances which do exist, it would not be to their selfish interest. I believe he is contradicting his own testimony.

By the COURT:

All right.

By Mr. SATTERFIELD:

Q. Now in arriving at uh this, these dates that you have in line L on attachment four of Exhibit D-5, of course, one of these also appears on the first page of that exhibit in line L. In arriving at those years uh you assumed a continuation of the policies and businesses, business of the bank uhh as it existed during that year, did you not?

A. I assumed that they would be in a position to pay out as much in the retirement of the Class A, B, and C Stock in the future as they had paid out in the retirement of Class A Stock in the year being considered.

Q. You assumed that they would be in a position to do so and with reference to C as well as A Stock, you assumed that they would do so, did you not?

A. Yes sir.

Q. Now in that connection, at what point did you uh consider the fact, if you did consider it, that if the New Orleans Bank for Cooperatives determined it desired to increase its net worth its financial position and its ability to lend, then it would retain these earnings rather than revolving out the C Stock. Did you consider that at all?

A. I con, I considered that.

Q. You gave no weight to it though, did you, because your entire compilation was that it would be retired as soon
199 as it was possible to do so under—

A. I made a very conservative estimate based on what was being done in that year projected into the future. The estimate was so conservative that it made allowance for a lot of lee-way for the operation of the bank.

Q. Would you show me where you made any lee-way whatsoever for any change in the policy of revolving out of C Stock? You testified awhile ago, you assumed that they would revolve out both the A and the C as soon as they were financially able. Did you make an incorrect statement a while ago?

A. You'll have to state that again. I didn't understand the question.

Q. A while ago, you—

A. You started in on one and you ended up with another one.

Q. I'll ask you again. Mr. O'Farrell, you testified a while ago that your assumption was that it would be revolved, both the A and C would be revolved upon the basis of the financial situation existing at the time under the policies and procedures then existing, did you not?

A. I took a very limited, made a very limited assumption as I mentioned a while ago. That they would continue to be able and they would continue to do what they were
200 doing the year in which I was concerned.

Q. Then the answer to my question is yes, is it not?

By Mr. WARREN:

Your Honor, I think the answer speaks for itself—

By the WITNESS:

I don't know the answer. I think I answered your question.

By Mr. WARREN:

The answer speaks for itself.

By Mr. SATTERFIELD:

I believe so. I think he said yes.

By the COURT:

All right. We'll take a fifteen minute recess.

(Court recessed at 10:52 A.M. for 15 minutes.)

By the COURT:

All right, Mr. Satterfield. You may proceed.

By Mr. SATTERFIELD:

Just one moment, Judge. I've got to get this all organized here.

Q. Mr. uh O'Farrell, would you turn to Exhibit D-5 and point out the factor, if any, you utilized in considering the fluctuation in the value of a dollar as contained in your calculation?

A. There is no factors identified as factors in that calculation.

Q. Yes sir. Would you point out the factor, if any, relating to or compensating for the uncertainty affecting the date upon which payment might be made as related to the change in the interest over-ride which was a variable fixed in the statute of some ten percent to twenty five percent over-ride on interest paid. What is that factor, if anywhere?

A. The factors that are assumed in this are B—

Q. Do you mean that you assumed there was no change, there would be no change?

A. The factors that are assumed in here are B, the interest rate in E and the annual rate for discounting in M and as far as the calculations are concerned, they contain a, an amalgamation and an integration of the various factors that would be variables.

Q. May I restate the question and ask you to respond to my question? Would you point out to us on any page of Exhibit D-5 any factor utilized uhh compensating for the uncertainty existing in the statutory right to vary the interest over-ride from

ten percent to twenty five percent? In fact, there is none, is there?

A. It would be in B and uh M.

Q. How does it appear in B?

A. In a very conservative estimate—

202 Q. Yes sir—

A. That would allow for a considerable amount of discretion on the part of the bank and considerable variation in the economy from year to year.

Q. Would you point it out on attachment two, please sir? Uh which is a detail to Exhibit D, would you point at at which you have utilized such factor?

A. In which exhibit are you speaking of?

Q. You referred to number B on page one and stated it contained a factor compensating for the uncertainties arising from the right to vary from ten to twenty five percent in the interest over-ride. You stated there was such a factor appearing under Item B which is explained in attachment two. Would you please take your pencil and point out to the Court and to me that factor and exactly of which it consists?

A. Two hundred and twenty nine thousand eight hundred dollars on that sheet and twelve percent down below.

Q. Now the two hundred and twenty nine thousand and eight hundred dollars is the amount that was actually retired that year, I mean the amount that was actually uh entered that year by the bank, is it not, for Class C Stock?

A. Is the amount of Class A Stock retired that year.

203 Q. Is this, there are two hundred and twenty nine dollars, two hundred twenty nine thousand eight hundred dollars. Exactly what is that figure? What does it represent?

A. That was taken from the reports of the bank indicating the amount of Class A Stock retired during the year ending June the 30th, 1958.

Q. That was based on a then interest over-ride of fifteen percent, was it not?

A. It was based on a lot of factors. One of the factors involved was the over-ride.

Q. And that was fifteen percent, was it not, Mr. O'Farrell?

A. I understand it was.

Q. Yes sir. Then, as a matter of fact, there is nowhere in any of these compilations in which you have entered any factor

compensating for any variation from fifteen percent for the reason that each one of these columns on attachment two and all related matters as to that item are based solely upon fifteen percent? Would you answer yes or no and then explain?

By Mr. WARREN:

I object, Your Honor, the question's argumentive.

By the COURT:

I'll let him answer if he can.

204

By the WITNESS:

I have made allowance for it in the two hundred and twenty nine thousand and eight hundred dollars and in the twelve percent.

By Mr. SATTERFIELD:

Q. On fifteen percent in these dollars, would you answer my question, please sir? In each one of these items that appear under the column Class A of attachment two, Class A Stock retired that was based on an exact fifteen percent over-ride on interest utilized by the bank that year, was it not?

A. For that particular year, yes sir.

Q. There was nothing included therein which would compensate for any variation in the future as to the remainder of the thirty one point nine years involved in the 1938 stock was it?

A. This is an estimate for the remaining years. For the Year, 1958, it was an actuality. As an estimate, it includes a lot of factors. As an actuality, it includes uh may be the factors that you have designated.

Q. Which is the fifteen percent, yes sir.

A. And as an actuality in the year in which it's reported.

Q. Now after these questions, Mr. O'Farrell, don't you
205 feel free to say that in a number of these calculations have you entered any factor which would compensate for a change in the interest over-ride from fifteen percent to ten percent?

A. I have, in the two hundred and twenty nine thousand eight hundred and in the twelve percent.

Q. In the two hundred twenty nine thousand eight hundred, that was based upon fifteen percent you stated a while ago—

A. It is my estimate to retire annually on an average basis of the Class A Stock and the other stock uh after Class A Stock is retired.

Q. You mean to tell this Court that at any point in this uh compilation or calculation you have utilized any figure in re-

lation to the funds available on the interest over-ride other than fifteen percent?

A. There are—

Q. Would you answer my question yes or no and then explain, please sir?

A. Will you repeat the question, please?

Q. The question is do you mean to tell the Court that at any point in this entire compilation or calculation have you utilized any interest over-ride figure other than the fifteen percent?

A. I have allowed—

206 Q. Would you answer yes or no?

A. I have allowed for the possibility that the interest over-ride would be changed.

Q. Would you point out; now you said that is included in the two hundred twenty nine thousand eight hundred dollars. How was it included?

A. And the twelve percent.

Q. How was it included in the two hundred twenty nine thousand eight hundred dollars?

A. After reviewing the affecting factors, I concluded, on a conservative basis, that it would be reasonable to forecast the retirement of the stock at the rate of two hundred twenty nine thousand and eight hundred dollars a year which was no higher than they had proved that was reasonable to retire in the Year, 1958.

Q. Which was exactly based on fifteen percent over-ride, was it not?

A. Had nothing to do with the fifteen percent over-ride as far as the future was concerned as an absolute. It made allowance for any kind of an over-ride between ten and twenty five percent, the statutory limit.

Q. But the figure, two hundred twenty nine thousand eight hundred was based on fifteen percent only, was it not?

A. In 1958 it was, not for the future.

207 Q. In the future, do you mean to say that when you have a calculation here of two hundred and forty seven thousand in 1959 that was based on anything other than the fifteen percent over-ride on this attachment two?

A. I concluded back in 59 that based on what was being done that year, you could reasonably conclude that they could do that in the future also.

Q. And that was fifteen percent, wasn't it?

A. In 59 it was, not necessarily in the future.

Q. It was in every year you utilized, was it not? Fifteen percent?

A. It was in the year in which we are speaking of, not for the subsequent.

Q. And for the future years, would you point out to me the exact spot in which you have changed from fifteen to ten on any other percentage on over-ride?

A. There is no exact spot where I changed it.

Q. Now you stated in your direct testimony that the twelve percent was based upon your own individual estimate of the risk involved, you referred to risks such as uh the instruments secured by second mortgages, E T C and that it uh, that was chosen for that reason. Do you change your testimony now and say it was chosen because of the possibility of a change
208 in interest over-ride?

A. The interest over-ride is one of the risks.

Q. I see. Then in that connection, there is also a risk, is there not, the spread which the bank would be able to uh obtain between the money borrowed and money loaned. Is that not also a risk varying from year to year?

A. It's an uncertainty. I don't know whether you would say a risk and uncertainty are identical but there is an uncertainty which all uncertainty adds to risk.

Q. Thank you, sir. Now that also, well you stated that the value of a dollar is one. Now with reference to this same question of the risk or uncertainties uh there remains the one that the, talked about a while ago that the bank might decide to pay off C Stock in cash if and when the stockholders got control of it, uh does it not? As you just testified a few minutes ago.

A. I don't understand your reference to the bank paying off C Stockholders in cash.

Q. Well, we've covered that. I won't go back over it. Now there is also an additional factor, is there not, I believe you heard some testimony yesterday, additional factor, is there not, that when the A Stock is paid off, then the bank be-
209 comes an organization somewhat in the nature of a non-exempt cooperative and is subject to payment of taxes of all phases of the business uhh that fall within the

taxable income of a non-exempt cooperative. Where have you in this calculation and formula entered the factor, and please put your finger on it and describe it, uhh allowing for the additional taxation which will result at that time?

A. In the tabulation it would be in the two hundred and twenty nine thousand eight hundred dollars and the twelve percent.

Q. I see in the two hundred and twenty nine thousand and, and the twelve percent. Now where have you included the factor which takes in account the risk of the, the question of the board determining to increase its net worth and ability to serve and retaining cash funds instead of revolving out C Stock?

A. It's in those two factors also, the two hundred and twenty nine thousand eight hundred and the twelve percent.

Q. I see, sir. Thank you, sir. Where in these calculations and formula uh is the, is included the risk or uncertainty or rather not uncertainty either, but the certainty that when the A Stock is paid out that it will be, this cooperative will be, this
210 bank will be required to pay twenty percent of its patronage refunds in case under the Act of 1962?

A. That act wasn't passed until the latter part of this period but the chance of such an act being passed is one of your uncertainties and the bank in its setting of interest rate has the sufficient authority to take care of these earnings from year to year within reasonable limits.

Q. As a matter of fact, that act was passed in the Fall of 1962, the year, two of the years, I mean the year involved for each of these taxpayers the year ending June 30th, 1963, therefore, when you analyze and calculate or fixed your opinion of the value of stock as of June 30th, 1963, it would necessarily include the knowledge of the existence of this act, would it not?

A. Yes sir.

Q. Has that, uh where in this compilation does that particular uhh formerly risk now certainty appear?

A. For the Year, 1963—

Q. Right.

A. It would be in the three hundred and ninety thousand dollars on line B, and the six percent on line M.

Q. Now as a matter of fact, the three hundred and ninety thousand dollars was the exact amount which was

211 thus disposed of without the application of the 1962 Act, was it not, which does not become applicable until the A Stock was paid out?

A. That was correct.

Q. Yes, sir. Then how is it in that figure when you are taking the exact amount paid out when the act was not applicable, and couldn't be applicable?

A. The years after 1963 are being considered and the basis of the estimate is that they will be able to continue the practices, reasonably continue the practices that they have established and are illustrated by what they did in 1963.

Q. Now, Mr. O'Farrell, when you turn to your attachment number four to Exhibit D-5, to calculation for the 6th of uh June, I mean uh June the 30th, 1963, you uh project the possibility of same in the period of twenty point three years. Under your calculation, the necessity of paying out twenty percent of the patronage refunds in case would arise prior to June the 30th, uh 1983, twenty years later, which is prior to the date you assumed this may be revolved, would it not?

A. June the 30th, 1883?

212 Q. That's 1963 plus twenty point seven years, I believe it is, the exact time. Twenty point three years. Isn't that 1983?

A. Right.

Q. And then in having knowledge of that and knowing it would go into effect if on the basis of these calculations you have used uh will you point out the factor, percentage, the item where you have taken that into consideration?

A. Three hundred and ninety thousand on line B and the six percent on Line M include these various factors, including that factor.

Q. You don't mean to tell the Court the three hundred and ninety thousand dollars is calculated on the basis of twenty percent case uh dividends was it? On patronage refunds?

A. It was calculated, as far as this development is concerned, on the basis of the bank being able to maintain what had been established and was an actual fact at that time.

Q. Now, Mr. O'Farrell, you have testified to some six various factors which were contained in and computed for by the use of the exact number of dollars each year in uh your Item B without changes, and except this last one on the twenty

percent, by the use of twelve percent as the rate of discount for the year ending June the 30th, 1958; during this
213 entire period, from June the 30th, 1958 to June 30th,

1963, every one of these risks or uncertain factors compensated for by the twelve percent was in existence when you used ten, nine, eight, seven or six percent, was it not? With the sole exception of this twenty percent patronage refund?

A. The factors that you have illustrated by your questions preceding this, for instance the tax—

Q. And all these other—

A. All—

Q. Sir?

A. They were in effect—

Q. I can't hear you, sir, I'm sorry.

A. All of these risks were in the future during all of this period.

Q. But they all were in effect in each of these years other than the twenty percent case refund, were they not?

A. Yes, they were all uh, all risks in each, in each of these periods.

Q. And that, uh they were compensated for the first year in the twelve percent, then you reduced that to six percent; even though all of the risk still existed and there had been added a new risk, isn't that true?

A. They, among many other risks, were apparent during all of this period.
214

Q. Thank you.

Now, would you give the witness uh the uh exhibit attachments to the stipulation which have been introduced, the, and it will be Exhibit number 17, I believe, which will be the manual of the bank for cooperatives.

By the COURT:

That's a number in your stipulation rather than an exhibit.

By Mr. SATTERFIELD:

I'm sorry, yes, that's true.

By the COURT:

What is the exhibit number here?

By the CLERK:

P-2.

By the COURT:

P-2?

By the CLERK:

Yes sir.

By the COURT:

All right.

By Mr. SATTERFIELD:

Q. That would be Exhibit P-2, the attachment thereto being Exhibit uh 17 to Exhibit P-2. Would you turn to paragraph numbered one sixty seven of the manual, please
215 sir, or numbered as Section one sixty seven. That is headed, Distribution of Allocated Surplus, is it not?

A. Distribution of Allocated Surplus.

Q. Now in your, in connection with your inclusion on the basis that you have referred fully today of allocated surplus with Class C Stock uhh is it not a fact that, as is set forth in this manner that there is a very material difference in the time within which allocated surplus may be expected to be revolved out, the value thereof and a great difference between it and Class C Stock by the fact that it is only when the such account of a bank for coöperatives at the end of the fiscal year exceeds twenty five percent of the sum of all of its outstanding capital stock and the surplus exceeds equally or exceeds ten percent of the net worth or such larger percentages as may be determined by the Board of Directors with approval of the Farm Credit, that the Board of Directors of the Bank may order the distribution of the allocated surplus as provided by the law. Is that correct, sir?

A. Yes, if that's what it says, yes.

Q. Would you read it and see if that's what it says,
216 and answer yes or no?

By Mr. WARREN:

If your Honor Please, the uh section of the manual speaks for itself.

By the COURT:

I think so. Sustained.

By Mr. SATTERFIELD:

Q. Now, Mr. O'Farrell, I have one other phase of questioning. Uh You are familiar, are you not, with Revenue Ruling uh 59-60, of the Internal Revenue Service, Treasury Department?

A. Generally, yes sir.

Q. Uh that sets forth the procedures for the valuation to be utilized applicable to uh corporate stocks uh therein described, does it not?

A. Under certain conditions. I think it was set up originally for taxes, uh for stocks in estates but it's obtain rather general application.

Q. It further provides, after referring to estates and so forth, the matters discussed herein will apply likewise to the valuation of corporate stocks on which market quotations are either unavailable or such scarcity they do not reflect the fair market value; then that would apply to this stock, would it not, Mr.

O'Farrell?

217 A. It could be applied to it.

Q. Reasonably so, you think in your opinion that reasonably so it could be applied to it?

A. It, among other things could be applied.

Q. Well now let me ask you, please sir, in that particular revenue ruling, there is set forth the basis of valuation of stocks of the nature which I have described and of the nature now before you, and is it not a fact, let me ask you whether or not in uh arriving at the valuation here, you have utilized all of the factors therein included?

A. The ones that are relevant, I believe I have.

Q. Beg pardon?

A. The one's that are relevant, I believe I have utilized.

Q. I see. Well now reference, one of the factors under section four provides that uh you should take into consideration the economic outlook in general and the conditions and outlook of specific industry in particular. I believe you stated that you have generally but have not considered the value of a dollar as applied to these figures. Is that correct, sir?

A. I don't remember that I said that I hadn't considered it; uh the value of a dollar but I took into consideration economic outlook and industrial outlook for the industry.

218 Q. But you did state that you did not include any factor varying the compilations in accordance with the expected valuation of the dollar, did you not?

A. I said the various factors were included in the uh different items that I mentioned for each of the years.

Q. In one case, twelve percent and another case, six percent?

A. Yes sir.

Q. Yes sir, I see. Now uh one of the items under section 401E is a dividend paying capacity; there is no dividend paying capacity in this instance, is there?

A. There might be some dividend paying capacity but it had no record of dividends and no dividends would be paid on the C Stock.

Q. Then insofar as C Stock was concerned, there was no dividend paying capacity was there? Under the law?

A. Not at that time, no.

Q. And, or at this time as far as you know. Right?

A. Far as I know.

Q. Yes sir. Now uh when it comes to the question of 219 the book value of the stock and financial condition of the company, the, the uh stipulation statute and the testimony here shows that the C Stock regardless of when paid—

By Mr. WARREN:

Your Honor, I object to recitation of what the evidence shows, what the stipulation shows. If Counsel wants to ask the witness a question, I have no objection to that but recitation of all that's gone on before getting down to asking the witness a question seems to me to be improper and to over, uh make the trial over-long and is rather useless as I see it. I object to it.

By the COURT:

I don't know what the preface is. He's prefacing a question, I assume. I'll wait and see what his question is and see if it's objectionable.

By Mr. SATTERFIELD:

Q. Under the, the statute, the stipulation in evidence here it has been shown without dispute that the C Stock, if and when retired, would be retired at par period, therefore, when it comes to the matter of the book value of the stock, or the possible growth of the increase of book value, upon your assumption that the Class C Stock will be retired, no weight was 220 given in your calculations to an increase in the book value of the stock, was it?

A. No answer.

Q. What is your answer?

A. Not that I specifically remember that I considered any addition to book value.

Q. So that insofar as this stock is concerned, that item of valuation was not applied by you, right?

A. If considered, it's not given any particular weight.

Q. Yes. Of course, the sales of the stock, you have already stated, were not considered by you, you knew of none, is that correct? Another item that is basis of valuation?

A. I didn't understand you?

Q. That you did not consider the sales of the stock or the size of the block of the stock to be valued?

A. I didn't have, I have told you before I could find no record of sales that were comparable and the block of the stock, I didn't think of the significance as far as determining its value.

Q. One of the items of valuation required to be considered under the, this regulation is the market value of stock of corporations engaged in the same or similar line of business having their stock actively traded in a free open market either an exchange or over the counter. That factor was not utilized by you in any way, was it?

A. It wasn't considered relevant.

Q. Then uh as a matter of fact, these elements which are required by this uh ruling to the extent stated have not been applied by you in this case, have they?

By Mr. WARREN:

I object, Your Honor. I don't think that the ruling requires any specific factor to be taken into account. These are the factors, I believe, the regulations requires may be taken into account.

By the COURT:

I'll let him answer. Overruled.

By the WITNESS:

The relevant factors were considered but many, uh many factors after it's been considered, have not been considered relevant as far as value was concerned.

By Mr. SATTERFIELD:

Q. Now as a matter of fact you have stated that you are familiar with this uh ruling.

Do we have a copy of this? Could you hand it to the witness?

By the WITNESS:

Thank you sir.

222 Q. It is a fact, Mr. O'Farrell, is it not, that under this ruling applicable to the valuation of the stock there-in described as heretofore testified by you that there is no reference whatever to a consideration to the value of money payable at some certain or uncertain time in the future, is there?

A. There is in those factors that I've mentioned before, the B and the M.

Q. You say that—

A. There is.

Q. I couldn't hear the first part.

A. I said there is in the factors that I have mentioned before which are identified as in the lines B and M of the attachments that we have discussed.

By the COURT:

That's attachment four. Is that what you're saying?

By the WITNESS:

Yes sir, attachment number four.

By Mr. SATTERFIELD:

Q. It will be necessary, Mr. O'Farrell, to clarify your various references to attachment, uh to number B which is attachment two. In this, didn't you testify this morning in response to a question of your own Counsel that the items therein entered were simply taken from the annual statements of New Orleans Bank for Cooperatives and the Farm Credit Administration for each of the years involved without alteration or change by you?

A. Yes sir.

Q. There has been included therein no change relative to any other factor whatsoever, a simple transcription of figures, is that right?

A. No changes that I know of.

Q. Yes, sir, thank you. But as to the item you referred to as uh item number, number N, M uh that is the item which uh is the varying from twelve percent you first adopted to the six percent you later adopted, isn't it?

A. Yes sir. Yes sir.

Q. And as to the question I just asked you as where this actually appeared, then it appears in each of, each one of those percentages all the way through, does it not?

A. I don't know that it appears in each one but it appears in the combination of those two throughout the six years of appraisal.

Q. I mean does it appear in each one of the percentage factors on Line M?

A. It appears in each one of the percentage factors used in relation to the figures on line B.

224 Q. Now, Mr. O'Farrell, do you testify that in your opinion an investor in 1963 would have been willing, willing buyer, willing seller would have been willing to pay thirty eight dollars and sixty six cents for a stock with a par value of one hundred dollars, no possibility of appreciation through the growth of the corporation, with no interest payable, the earliest date at which it might be payable being twenty point three years hence subject to the uncertainties which you have mentioned as to an extension of that date. Do you testify in your opinion that you, individually, or any investor would pay that sum of money for that security at that time?

A. I estimate that's the fair market value at that particular time.

Q. You didn't answer my question.

A. Under the definition of fair market value, you have a willing buyer and a willing seller. I don't know that the definition says you've got to have a sale.

Q. The answer to my question then is no, that you wouldn't pay it?

By Mr. WARREN:

I object, Your Honor, the witness has answered the question that Counsel has asked.

225 By the COURT:

Well, he's been a little bit evasive about it. I'll let him—

By the WITNESS:

A willing buyer would have bought it under the definition of fair market value.

By Mr. SATTERFIELD:

Q. Would you have paid that much for—

By Mr. WARREN:

Objection, Your Honor—

(All talking, including witness).

By the COURT:

Gentlemen, there are too many people talking at one time. Let him finish his question. If you don't like it, object to it and I'll rule on it. Ask your question.

By Mr. SATTERFIELD:

Q. What was your answer?

By The COURT REPORTER:

I didn't get all of your question.

By Mr. SATTERFIELD:

Q. I asked the question as to whether or not you would have been willing to purchase this stock at that price. I believe your answer, Mr. O'Farrell was that you were not a willing buyer, is that right?

226 A. I am not the willing buyer. I am the appraiser.

By the COURT:

I'm not discouraging objections. I am discouraging interruptions of questions.

By Mr. SATTERFIELD:

Q. Now where a common, have you, you have testified you consider this in the nature of common stock of a restricted nature, do you not?

A. I don't know what you mean by restricted.

Q. Subject to the restrictions as to whom it may be sold, as to when it may be, all the various matters that we've discussed.

A. It is restricted in the sense that there were not many potential buyers.

Q. Do you consider this to be in the nature of capital stock or common stock, to be a capital stock or a common stock?

A. Yes sir.

Q. I see. Now uhh—

By the COURT:

What are the characteristics of common stock that's in here in the Class C Stock?

By the WITNESS:

227 It's an equity interest which means that it doesn't have a, a lien on any of the property in itself like a debt interest a bond would, and it represents the control of the enterprise, the ownership control of the enterprise; and it represents the control not only through the future of the company but through the uh present operations. There isn't very much else except that it reserve, it has a right to participate in

earnings under the conditions that are outlined by the by-laws of the company but that, in this case, is a very restricted right. But mainly, it's control which is the primary characteristic of a common stock.

By the COURT:

That's right, but then you are saying then that these C Stock-holders own this business?

By the WITNESS:

Yes, I would say they own the business.

By Mr. SATTERFIELD:

Q. Your testimony heretofore has been, included that basis, has it not? —

A. Yes sir. —

Q. That you just told the Judge?

A. Yes sir.

Q. I see, sir.

Just a moment. Just one second. May it please the Court, we have no further questions.

OPINION

United States District Court, Southern District of
Mississippi, Western Division

Civil Action Number 1213

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

Civil Action Number 1214

COASTAL CHEMICAL CORPORATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

These consolidated suits seek a recovery of income taxes back-assessed and paid for the fiscal years (ending June 30) 1961, 1962, and 1963, and for the additional years 1958, 1959,

and 1960 as to Coastal Chemical Corporation. The plaintiffs are Mississippi corporations created as cooperative associations as defined in the "Agricultural Marketing Act" as amended.¹ The New Orleans Bank for Cooperatives had Class A stock, Class B stock (neither of which is involved in any way in this suit), and Class C stock (owned by these cooperatives) which gives rise to these suits by reason of the divergence of opinion as to the fair market value of such Class C stock during the tax years stated.

The qualities and attributes and rights accorded the holder of such Class C stock is regulated by statute² and is committed to the ultimate control of the New Orleans Bank for Cooperatives.³ The plaintiffs were not eligible to borrow funds from the cooperative bank without owning a qualifying share of such Class C stock. The bank required these cooperatives to purchase from it 15% of the amount of each interest payment made quarterly on its loan in exchange for shares of said stock credit at one hundred dollars per share par value. These shares of stock were carried on the plaintiffs' books at one dollar per share and were actually considered and treated as having no value during the period in suit. These forced purchases of such stock were authorized by 12 U.S.C.A. Sec. 1134d(a)(3). Periodically, the bank issued these plaintiffs certificates of credit for additional shares of Class C stock at the end of each year as "patronage refunds," as authorized by 12 U.S.C.A. Sec. 1134l(b), effec-

¹ 12 U.S.C.A. Sec. 1141 et seq.

² It is interesting, if not somewhat persuasive, to notice that tax decision No. 6428 (December 2, 1959) following *Long Poultry Farm, Inc. v. Commissioner of Internal Revenue* (4CA) 240 F. 2d 726 and *Commissioner of Internal Revenue v. B. A. Carpenter*, (5CA) 219 F. 2d 635 in dealing with a cognate question as to market value of a document payable only in the discretion of a cooperative association "or which is otherwise subject to conditions beyond the control of the patron, shall be considered not to have any fair market values at the time of its receipt by the patron, unless it is clearly established to the contrary." The existence of market value or even actual value of this Class C stock as stock is not clearly established by the facts and circumstances in this case. The proof here is to the contrary.

³ The Class C stock can be retired at par without interest, but not until all government Class A stock has been retired, and all Class B stock has been retired which was issued during or prior to the year in which such Class C stock was issued and until all prior issued Class C stock has been retired. This may be done in the discretion of the Board of Directors of the bank and subject to the approval of the Farm Credit Administration.

tually as refunds of over-charges in the processing of such loans.⁴ Significantly, no certificates of Class C stock were ever issued by the bank, but the plaintiffs were simply notified of credit on the bank books therefor. None of this stock has ever been sold by any cooperative. Only a cooperative can hold such stock. No provision is made for its redemption or retirement, except by statute as to order of retirement with the Class A and Class B stock. The United States owns all of the Class A stock, and the bank has absolute control over such stock and no provision has been made, or can be made for any retirement of Class C stock until all Class A stock and outstanding Class B stock is retired. Regardless of the number of shares of Class C stock owned, the plaintiffs have only one vote as owner of Class C stock. If a borrower's account with the bank is inactive for as long as two years, the right to vote such stock is abated.

The Class C stock has no growth value and can be retired at par without interest. No dividend is paid on such stock. It may be readily seen that this Class C stock as a practical matter does not enjoy the usual attributes of shares of stock, but are mere bookkeeping entries or devices set up by the bank for the processing of loans to cooperatives. While the plaintiffs received certificates of credit on the books of the bank for Class C stock, some by purchase and other credits as statutory "patronage refunds," there is actually no significant difference in such Class C stock acquired in such different ways. It is a universal rule of law, applicable to such Class C stock credits, that any charge by whatever name called, or device employed as an exaction for or a condition precedent to a loan of money is interest.⁵ These plaintiffs did not voluntarily invest any money in any Class C stock of the bank, but did contribute funds to

⁴ The "patronage refund" is not income but simply a refund of an over-charge of interest. *New York Life Insurance Co. v. Anderson, Internal Revenue Collector*, (2CCA) 263 Fed. 527, cert. denied 41 S.Ct. 536 holds: "Excess premiums, collected by a mutual insurance company and returned to stockholders or applied to their credit, do not constitute income of the company within corporate excise tax act."

⁵ The act of Congress (12 U.S.C.A. Sec. 1141f) limits the interest rate on such loans to 6%. Regardless of how such a charge for the use of money is characterized, the universal rule is that interest is: "The amount which one has contracted to pay for the use of borrowed money. *Old Colony R. Co. v. Commissioner of Internal Revenue*, 284 U.S. 552, 52 S. Ct. 211." or "compensation for the use or forbearance of money." *Deputy v. Du Pont*, 308 U.S. 488, 60 S. Ct. 363.

the bank which it carried on its books as credit for said stock solely as an exaction by the bank without which such loans would not have been made by the bank. These credits were interest items incurred by these plaintiffs and not capital investments. The credits for Class C stock purchased were clearly disbursements for interest as a matter of law and the credits as "patronage refunds" were not income but were refunds of overcharge as interest. These plaintiffs simply owned letter credits showing as credits on the books of the bank, that they (plaintiffs) owned so many shares of Class C stock, without ever having actual possession at any time of any share or certificate of such Class C stock. Clearly, such Class C stock owned by the plaintiffs could not possibly have any appreciable market value under such circumstances and conditions, coupled with the statutory restrictions on said class of stock.

These plaintiffs made timely and proper demand for refund and made known the basis therefor, and this Court has full jurisdiction to that which is herein done.

In sum, this Class C stock acquired by the taxpayers during the years in suit did not represent voluntary investments. The plaintiffs were forced to purchase stock at each quarter interest paying date equal to 15% of each interest payment. This obligation had to be satisfied by money, and could not be satisfied by Class C stock already owned. The Class C stock whether acquired by purchase or "patronage refund" was the same, and represented interest refunded or money paid for the use of money lent by the bank. This stock was not worthless, but had merely a nominal value because of the unusual attributes stated. The value of such stock arrived at by applying the prevailing discount rate on a hundred dollar par value certificate, not bearing interest and not producing dividends, to be revolved or retired at some indeterminate period of time in the future (not less than twenty years or before 1989) would not have any market values, but would nevertheless have only a nominal value of not more than one dollar per share. The ninety-nine dollars remaining in the par value of this Class C stock owned by these plaintiffs was deductible by them as interest during the tax years involved. The plaintiffs are accordingly entitled to a judgment against the defendant for such amounts indicated, with statutory interest. No cost will be assessed. A copy of this opinion shall be filed in each case sep-

arately as embracing the finding of facts and conclusions of law therein.

In The United States District Court for the Southern Judicial
District of Mississippi—Western Division

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

v.

7

THE UNITED STATES OF AMERICA, DEFENDANT

Civil Action No. 1213

JUDGMENT

(Filed Mar. 24, 1969)

This Cause coming on to be heard in the Vicksburg Division during a regular term of this Court by the consent of the plaintiff and the defendant given in open Court, and the Court having considered the pleadings, the Stipulation of Facts, and the briefs of counsel for the plaintiff and for the defendant, and the Court being fully advised in the premises, having entered its opinion on February 14, 1969, finding that the plaintiff is entitled to recover the amount hereinafter set forth.

It is, therefore, ordered, adjudged and decreed that the plaintiff, Mississippi Chemical Corporation, a corporation, do and have recovery of and from the defendant, The United States of America, the principal sum of \$85,298.51, together with interest thereon at the rate of six per cent per annum as follows: From April 4, 1966, upon the sum of \$33,859.37, from June 29, 1967, upon the sum of \$20,006.11, and from July 21, 1967, upon the sum of \$31,433.03, all interest being payable until this Judgment is paid.

For which let execution and other proper process of this Court issue.

ORDERED, ADJUDGED AND DECREED this 28th day of February, A.D., 1969.

(s) HAROLD COX,
United States District Judge.

United States District Court, Southern District of
Mississippi—Western Division

COASTAL CHEMICAL CORPORATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

Civil Action No. 1214

JUDGMENT

(Filed Mar. 24, 1969)

This action came on for trial before the Court and the issues having been duly tried and a decision having been duly rendered, it is ordered and adjudged:

- (1) That the plaintiff, Coastal Chemical Corporation, recover of the defendant, United States of America, the sum of \$265,044.35, plus interest thereon as provided by law;
- (2) That no costs be assessed herein.

ORDERED AND ADJUDGED, this March 22, A.D., 1969.

(s) HAROLD COX,
United States District Judge.

OPINION

In the United States Court of Appeals for the Fifth Circuit

No. 28271

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

COASTAL CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeals from the United States District Court for the
Southern District of Mississippi*

(September 14, 1970)

Before GEWIN, GODBOLD and CLARK, Circuit Judges²

GEWIN, Circuit Judge: The government appeals from separate judgments entered for Mississippi Chemical Corporation and Coastal Chemical Corporation (hereinafter, taxpayers) in their suits for refund of federal taxes. Taxpayers based their claims for refund on the contention that \$99 of each \$100 expended for the purchase of certain Class C stock in the New Orleans Bank for Cooperatives constituted deductible expenses in the year of purchase. The government contended that these amounts were the non-deductible costs of acquiring capital assets. The district court concluded that the payments were deductible as interest expenses, and we affirm.

Taxpayers are Mississippi corporations with their principal place of business in Yazoo City, Mississippi. During the tax years in question they were "cooperative associations" as defined in the Agricultural Marketing Act.¹ Taxpayers are stockholders in, and borrowers from, the New Orleans Bank for Cooperatives (hereinafter, the Bank). The Bank is part of a banking system created by the federal government² during the depression to provide low cost loans to farmer's marketing, purchasing, and service cooperatives. It is one of the twelve regional banks in the system and serves Louisiana, Mississippi, and Alabama.

The governing legislation³ provides for three classes of stock in a regional bank. Class A stock represents the original capital

¹ 12 U.S.C. § 1141(j).

² 12 U.S.C. § 1134.

³ 12 U.S.C. § 1134(d).

contributed by the United States. These shares are non-voting and pay no dividend. The legislation contains a scheme of retirement for Class A shares which is dependent on the amount of Class C stock purchased and on the net profits of the regional bank. Class B stock may be issued to any person. It is non-voting but may bear a dividend not to exceed four percent per annum. Class C stock may only be issued to banks for cooperatives and to farmers' cooperative associations. It pays no dividend. Each holder of Class C stock is entitled to one vote, though a cooperative has only the single vote regardless of the number of Class C shares held.

Farmers cooperatives, like taxpayers, acquire Class C shares in three ways: (1) Each cooperative must purchase a qualifying share of Class C stock to be eligible to borrow from the Bank. (2) A borrower cooperative is required to make quarterly investments in Class C stock; these purchases are referred to as "interest override" payments. The amount required to be invested is not less than ~~ten~~ nor more than twenty-five percent of the interest payable by the borrower for that quarter, to be determined by the Bank's director. (3) Class C stock is also received by farmer's cooperatives as a distribution of the Bank's net profits during a fiscal year. These distributions, called "patronage refund", are computed in amount "in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year."⁵

Mississippi Chemical Corporation acquired its qualifying share of Class C stock in 1956; Coastal Chemical Corporation purchased its share in 1957. Each carried its initial share on its books at the \$100 cost, and neither sought a deduction for any part of this expense. These qualifying shares were not involved in the suit below.

Mississippi Chemical's suit concerned the fiscal years ending 30 June 1961, 1962, and 1963. As a result of its borrowings during those years it was required to make "interest override" purchases of 189, 169, and 193 shares of Class C stock respectively. The purchase price of each share of stock was \$100. In its tax returns for each year, Mississippi Chemical reported \$1

⁴ The rate for the New Orleans Bank during the periods in question was 15%.

⁵ 12 U.S.C. § 1134(1)(b).

per share as the cost of acquiring a capital asset and claimed a deduction in the amount of \$99 a share as an interest expense. In the same fiscal years, Mississippi Chemical received "patronage refunds" of 287, 275, and 251 shares of Class C stock respectively. It reported \$1 per share of the "patronage refund" as a reduction of interest expense and investments, but it made no report of the remaining \$99 of par value of each share.

Coastal Chemical's suit involved a longer period of time including the fiscal years ending 30 June 1958 through 1963. In these years Coastal Chemical purchased 118, 339, 473, 417, 351, and 421 shares of Class C stock respectively pursuant to the "interest over-ride" requirements. During the same years, it received 143, 474, 516, 605, 523, and 630 shares of Class C stock as "patronage refunds." In its tax returns for these periods, Coastal Chemical treated the shares purchased and those received as "patronage dividends" in the same manner as Mississippi Chemical.

The Commissioner disallowed the interest deduction claimed by each taxpayer and asserted deficiencies. Taxpayers paid the deficiencies and filed claims for refund which were disallowed. Taxpayers then instituted their actions which were consolidated for trial in the district court. The court below upheld the taxpayer's contention that \$99 of each \$100 expended for the purchase of a share of Class C stock was deductible as an interest expense. In the district court the government also contended that taxpayers should have reported the Class C stock received as patronage refunds as income. The court did not sustain this position and it has been abandoned by the government.⁶ As a result the present appeal is concerned solely

⁶ In a footnote to its brief the government states:

"The Government also contended in the lower court, that the taxpayers should have reported the patronage dividends (refunds) of shares of Class C stock during the taxable periods in issue as income. The lower court refused to sustain that contention. The Government has not appealed from that part of the judgment."

In this connection the following argument is advanced by amicus curiae:

"By failing to appeal from the decision below that Class 'C' stock received as patronage refunds must be included in plaintiffs' income only to the extent of \$1 per share, the government in effect concedes that the fair market value of such stock is no more than \$1 per share. Clearly the

with the tax treatment of the Class C stock purchased under the "interest override" requirements of 12 U.S.C. § 1134(1)(3).

I

Central to the district court's decision was its finding that the Class C stock,⁸ while not worthless, was without any appreciable market value and had at most a nominal value. This conclusion is attributable to the peculiar nature of these shares. Taxpayers could only sell or transfer Class C stock to another qualified farmers' cooperative with the authorization of the Bank's Board of Directors and the approval of the Farm Credit Administration. No share of the Bank's Class C stock has ever been sold by a cooperative,⁹ so there is obviously no market in this stock that would aid evaluation.

Additional characteristics of the stock severely limit its value in the hands of the taxpayers. It pays no dividend and has no growth potential. After the purchase of their initial, qualifying shares, taxpayers gained no voting rights by the purchase of additional Class C stock. The Bank has a first lien on all Class C

same standard must apply in assessing the value of the identical stock which is purchased pursuant to the requirements of a loan agreement."

See Commissioner v. B. A. Carpenter, 219 F. 2d 635 (5th Cir. 1955); *Long Poultry Farms v. Commissioner*, 249 F. 2d 726 (4th Cir. 1957); Treas. Reg. § 1.61-5(b) (1) (iv) 1959).

The same question has been involved in two recent cases. In *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372 (Cl. Ct. 1969), the Court of Claims held that amounts paid for Class C shares of the Springfield Bank for Cooperatives under the "interest override" requirements were currently deductible as interest. In *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo. 1968), the district court allowed current deduction of the cost of Class C shares in the St. Louis Bank for Cooperatives, but considered it an ordinary and necessary business expense rather than interest. On appeal the Eighth Circuit reversed the district court and held that the cost of Class C shares was not currently deductible. *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

⁸ The New Orleans Bank does not issue certificates for the Class C shares. Thus, Class C shares are really only credits entered on the books of the bank in units of \$100 and fractional parts thereof.

⁹ The Bank's Class C shares have changed hands only at the liquidation of a cooperative or its merger with another.

shares.¹⁰ While the governing legislation provides that Class C shares may be retired at some date in the future, retirement will be at par (\$100) and must await the prior retirement of all Class A stock and all senior Class B shares. Retirement is also subject to the discretion of officials of the bank system. Until this uncertain retirement date,¹¹ the shares have no value to taxpayers in the usual sense. The Bank will not accept Class C shares in satisfaction of future "interest override" obligations, nor will it accept Class C shares as collateral for a loan. These factors, the limited marketability and limited value of the shares themselves, make application of the normal "willing buyer and willing seller" standard, for determining fair market value,¹² unfeasible.

The government appears to concede that these shares have no market value,¹³ but urges that they possess an "intrinsic" or "intangible" value in taxpayers' hands which renders their cost a capital investment. First, it contends that taxpayers benefit from low cost loans and other Bank services because of the existence of the banking system assured through their continued purchases of Class C stock. As has been noted, however, the right to Bank services is established by the purchase of the initial qualifying shares. The government also points to the history of the Banks for Cooperatives¹⁴ which evidences a

¹⁰ 12 U.S.C. §1134(d)(c).

¹¹ For purpose of valuation, the *Penn Yan* court accepted 30 or 31 years as the period required before the stock would be retired based on the history of the Springfield Bank. It is not clear to what extent this figure reflected the discretion of the bank officials or other factors which could operate to defeat or prolong recovery.

¹² [Fair market value] is the price at which property will change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts.

Willow Terrace Dev. Co. v. Commissioner, 345 F. 2d 933, 936 (5th Cir. 1965).

¹³ The Government states in its brief:

"In truth, because of the special characteristics of the stock there is no reasonable and determinable market value which can be assigned to it. As one authority puts it [Packel, *Law of Cooperatives* (3d ed.), Sec. 45(d) at 234.]: The circumstances surrounding the issuance of revolving fund certificates are often such that no particular market value can be ascribed to the certificate even though it refers to a sum certain."

¹⁴ The history, organization, and capital structure of the Banks for Cooperatives is discussed by the court in *Penn Yan*, 417 F. 2d at 1373-1376.

Congressional intention ultimately to withdraw all government investment from the system. This is to be accomplished by the retirement of Class A stock as the federal investment it represents is replaced by Class C investment through purchases by cooperatives and receipt by them of "patronage refunds." The government urges that when all Class A stock has been retired, the revolving fund method of capitalization, common to cooperative financing, will prevail and the participating cooperatives will be the sole owners of a valuable financial institution. It should be noted that ownership here is not synonymous with control.

Prior to 1964, the holders of Class C stock of each [regional] bank could elect only one of its seven directors, and since 1964, they have elected two of the seven. The other five directors are elected by the local district production credit associations (two members), and the local district Federal Land Bank Associations (two members), with the seventh being appointed by the Governor of the Farm Credit Administration.¹⁵

With their share of control in the Bank thus limited, the fact that Class C shareholders were having capital they supplied substituted for that previously furnished by the government can scarcely be seen as enhancing the value of their shares. In *Penn Yan Agway Cooperative, Inc. v. United States*,¹⁶ the Court of the Claims rejected the same government argument—that the Class C share possessed intangible value. The court stated:

[T]he cold fact remains that when plaintiff cooperative shareholder paid the \$407 for the 4.7 shares, it received stock which was greatly less valuable from an economic and financial standpoint than the purchase price required by law and the terms of the loan agreements. The "intangible benefits" bestowed by Congress on farmers' cooperatives generally do not alter this fact . . . The required purchase of such stock gave plaintiff no economic or financial benefit other than the circumstance that it could not have obtained the loan with its

¹⁵ *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372, 1375 (Ct. Cl. 1960).

¹⁶ 417 F. 2d 1372 (Ct. Cl. 1959).

favorable interest rate without fulfillment of the statutory requirement. But in the extremely practical field of taxation, in which substance prevails over form, it cannot reasonably be concluded under the circumstances that Congress has granted favors to cooperatives in furtherance of agricultural policies and taken them away (on the theory of intangible benefits) in whole or part in the field of raising of public revenues. It is obvious under the facts of this case that plaintiff did not consider, nor could it reasonably be held to have considered, that its required payment of \$407 for such stock, was an investment, as no return on such purported investment could be realized, except repayment of the bare purchase price delayed for many years.¹⁷

In *Penn Yan*, the cooperative shareholder assigned a value of \$6.90 to its Class C shares and introduced expert testimony tending to support this general figure as a reasonable estimate of the shares' fair market value. The Court of Claims approved the cooperative's evaluation. In *M.F.A. Central Cooperative v. Bookwalter*,¹⁸ the district court concluded that Class C shares in the St. Louis Bank for Cooperatives had no fair market value at all. This conclusion was reversed by the Eighth Circuit which stated, "While the Class C stock has no established market value, it has a substantial book value and while it is likely not worth its par value at the time it is issued, it certainly has substantial value."¹⁹ It should be noted that there is a considerable difference, as to the factors affecting value, between the shares of the St. Louis bank and those involved here.²⁰ In the present case, considering the nature of the Class C stock and the testimony as to its value adduced in the district court, that court was not clearly erroneous in determining that the Class

¹⁷ *Id.* at 1377-1378.

¹⁸ 286 F. Supp. 956 (E.D. Mo. 1968).

¹⁹ *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

²⁰ From statements contained in briefs filed in this court, it appears that by June 30, 1967 the St. Louis Bank had completely retired its Class A shares and substantially reduced the amount of Class B investment. As a consequence it was able to redeem all Class C shares issued during the fiscal year ending June 30, 1956. The M.F.A. Cooperative had purchased St. Louis Class C shares from other cooperatives, and it appears that transactions between cooperatives were not uncommon.

C shares had no fair market value and no more than a nominal value to the taxpayers.²¹

II

Notwithstanding the absence of a fair market value for the Class C shares, the government contends that taxpayers were not entitled to deduct any portion of their purchase price. It cites *Montana Power Co. v. United States*,²² contending:

If one buys something and pays more than it is worth, and more than he can resell it for, there are no immediate tax consequences of this everyday occurrence. . . .

He must "realize" his bad bargain, his loss, by selling.

We do not dispute the soundness of this tax principle, but consider it inapplicable to the present case.²³ The government advanced the same argument in the *Penn Yan* case. The Court of Claims rejected it stating:

[I]t would be unfair to apply such a doctrine in the circumstances where disposition by the plaintiff of the Class C stock was a practical impossibility due to lack of a market, which resulted from the statutory restrictions placed upon such stock under the capitalization formula prescribed by law for the banks for cooperatives.²⁴

Montana Power and the other cases relied on by the government are readily distinguished for the present situation. Taxpayers in the instant case have not been the victims of a bad bargain in the traditional sense;²⁵ they were required to make continued purchases of Class C stock in order to secure loans from the Bank. Neither did taxpayers acquire an asset of continuing value, though less than the purchase price;²⁶ the

²¹ Rule 52(a) Fed. R. Civ. Pro.

²² 159 F. Supp. 593, 595 (Ct. Cl.), cert. denied, 358 U.S. 842 (1963).

²³ See *Ancl Green & Co.*, 38 T.C. 125 (1962); *McMillian Mortgage Co.*, 36 T.C. 924 (1961). These cases are thoroughly discussed in *Penn Yan*, 417 F. 2d at 1380-1381.

²⁴ 417 F. 2d at 1379.

²⁵ See *Montana Power Co. v. United States*, 159 F. Supp. 593 (Ct. Cl. 1958).

²⁶ See *Dresser v. United States*, 55 F. 2d 499, 512 (Ct. Cl.), cert. denied, 287 U.S. 635 (1932); *Koppers Co. v. United States*, 278 F. 2d 948, 949 (Ct. Cl. 1960).

Class C shares were of no appreciable value to the taxpayers. It is at odds with the incisive realism required in determining the tax consequences of ambiguous transactions to treat these purchases as "investments"; they were something else.²⁷

We agree with the trial court and with the Court of Claims in *Penn Yan*, that the purchase price of the Class C stock (in excess of the nominal value assigned it by taxpayers) is deductible as interest in the year of purchase. Section 163(a) of the Code²⁸ provides, "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The interest which is deductible under this section is defined as, "the amount one has contracted to pay for the use of borrowed money."²⁹ As we have noted the Class C stock was without practical value to the taxpayers. Their only reason for acquiring the shares was as a prerequisite for continued borrowing from the Bank. It was in effect a bonus or premium paid in addition to the usual interest, and comes within the meaning of interest under 163(a).³⁰ The *Penn Yan* court supported its similar decision with the proposition borrowed from usury cases that:

[I]f as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its

²⁷ One decision on this point appears to be at odds with that of the Eighth Circuit in *M.F.A. Central Cooperative v. Bookwalter*, — F. 2d — (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970]. Insofar as that court's decision is not attributable to the difference in value of the St. Louis shares, we are simply unable to agree. If we concluded, as did the Eighth Circuit, that the "interest override" payments were made to acquire Class C shares as capital assets, we would agree that recognition of gain or loss must ordinarily await realization through sale or exchange. However, we agree with the court below that, for tax purposes, the bulk of these payments were not *actually* made to acquire an asset.

²⁸ 26 U.S.C. § 163(a).

²⁹ *Old Colony Bk. v. Commissioner*, 284 U.S. 552, 560 (1932).

³⁰ *Wiggin Terminals, Inc. v. United States*, 36 F.2d 893 (1st Cir. 1929); *L-R Heat Treating Co.*, 28 T.C. 894 (1957); *Court Holding Co.*, 2 T.C. 531, 536 (1943), *rev'd on other grounds*, 143 F.2d 823 (5th Cir. 1944), court of appeals *rev'd* and tax court *aff'd* on other grounds, 324 U.S. 331 (1945). These cases are offered for the same proposition by the Court of Claims in *Penn Yan*, 417 F.2d at 1379.

value or to purchase property from him at an excessive price, the difference represents interest. . . .³¹

In M.F.A., the district court held that the amounts paid by the plaintiff cooperative for Class C shares of the St. Louis Bank for Cooperatives were not deductible as interest under § 163(a),³² but allowed a current deduction as an ordinary and necessary business expense under § 162(a).³³ The district court distinguished the cases allowing interest deductions for amounts paid as a bonus or premium to induce a loan,³⁴ since the debtors in those cases received nothing in return for the bonus but the use of the loaned money while the M.F.A. Cooperative had received Class C stock. Because of the peculiar nature of the Class C shares, we find this distinction unacceptable. As the district court itself observed:

This Class C stock purchased quarterly was of absolutely no use or benefit to M.F.A. Central Cooperative. . . . The only reason it was purchased was because M.F.A. Central wanted to borrow money from the St. Louis Bank for Cooperatives and the agreement to purchase Class C stock was imposed as a condition of the loan. It is impossible to separate the loan from the purchase of the stock. One was the motivation for the other.³⁵

The district court in *M.F.A.* also considered the loan agreement as significant evidence that the parties understood the obligations to purchase the Class C stock to be apart from the interest requirements. We do not feel that the attitude of the parties is controlling. We agree with the Court of Claims in *Penn Yan*:

³¹ 417 F.2d at 1379; quoting, *Memorial Gardens v. Everett Vinson & Assoc.*, 264 F.2d 282, 285 (10th Cir. 1959).

³² While the Eighth Circuit reversed the district court insofar as it allowed a deduction as a business expense, it adopted the district court's opinion on the question of interest. *M.F.A. Central Cooperative v. Bookwalter*, F.2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

³³ 26 U.S.C. § 162(a).

³⁴ See note 30 *supra*.

³⁵ 286 F. Supp. at 961.

that a current deduction was proper and that the appropriate deduction lies under § 163(a).³⁶ As that court noted this is more logical than the § 162(a) treatment initially given the expenses by the district court in *M.F.A.*, "particularly because the amount of such stock required to be purchased by law and by the loan agreements involved was measured by a percentage of the interest payable on plaintiff's outstanding loan obligations to the bank issuing the stock."³⁷

Accordingly, the judgment of the district court is **AFFIRMED**.

GODBOLD, Circuit Judge, dissenting:

The majority opinion is a demonstration of what one of the few authorities on the law of cooperatives has counselled against:

The entire field of cooperative corporation law is so relatively new, the basic principles of the cooperative plan are so fundamentally different from those of corporations for profit, and the temporary or interim character of the capital required for proper functioning of a cooperative is so different from the permanent share capital of other business corporations, that even well established concepts in the field of business corporation law cannot safely be applied to cooperative corporations without careful understanding of the reasons underlying those principles and the applicability or inapplicability of those reasons to cooperatives. The fable of the three blind men's impressions of an elephant holds a pointed moral for judges and lawyers approaching the problems of cooperative corporation law and, particularly, the problems of financial structure and operation of cooperatives. Revolving capital cannot be assumed to result from the creation of either an exclusively debtor-creditor relationship or an exclusively corporation-shareholder relationship. Rather it involves a blending of certain elements of both, and frequently something

³⁶ The quid pro quo for taxpayer's present deduction for an interest expense will arise when and if the Class C shares are redeemed. In that event taxpayers must take \$99 into ordinary income. *J. Chommie*, *Federal Income Tax* § 17 at 33 (1968); *I. J. Mertens*, *Federal Income Tax* § 7.34 et seq. (1969).

³⁷ 417 F.2d at 1382.

new has been added as well. The resultant product is *sui generis*. In the long run, the public interest will best be served by thorough, patient, and understanding comprehension of what participants in a cooperative enterprise are trying to achieve, rather than by unwarranted assumption that new legal relationships arising from cooperative business transactions and organizations must be neatly and quickly, albeit somewhat forcibly, classified according to preexisting legal concepts developed under different conditions for different purposes in different kinds of transactions and organizations.

Nieman, *Revolving Capital in Stock Cooperative Corporations*, 13 *Law and Contemporary Problems* 393 at 402 (1948).

The taxpayers are incorporated farmers' cooperatives. In issue is the tax treatment of amounts which they have paid for Class C stock which they hold of the New Orleans Bank for Cooperatives, an incorporated stock cooperative of which they are members and from whom they borrow.¹ The taxpayers say on the one hand that the amounts were not paid for a capital asset, which under 26 U.S.C. (1964 ed.) § 1221 is "property held by the taxpayer" (with designated exceptions none of which is contended to be applicable). They say that in truth all or substantially all of the amounts paid, though cast in the form of the purchase price of capital stock, really were amounts which they had contracted to pay for the use of borrowed money and therefore were interest.² As probative of both of these contentions their underlying argument is that the Class C stock lacks many if the usual characteristics of stock and that it has only nominal value. The government contends the stock is a capital asset, and, recognizing that it may not have fair market value in the usual sense of a willing buyer and a willing seller, says it has intrinsic value.

Once one grasps the function of this particular stock in an institution organized by the Congress as a cooperative³ it is

¹ The purchases were made by Coastal between 1958 and 1963 in the total amount of \$211,799.68, and by Mississippi Chemical between 1961 and 1963 in the total amount of \$55,113.19. Tax refunds ordered by the District Court are \$265,044.35 to Coastal and \$85,298.51 to Mississippi Chemical.

² E.g. *Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 76 L.Ed. 484 (1932).

³ Under a charter issued by the Farm Credit Administration.

seen that the stock is a capital asset, "property held by the taxpayer," although it does not have the usual characteristics of stock in a commercial enterprise organized under general corporation laws. Once that is seen—if not before—the contention that the payments for Class C stock are interest falls.

The Eighth Circuit in *M.F.A. Central Cooperative v. Bookwalter*, F. 2d [8th Cir., No. 19,527-531, June 8, 1970], has reached the same conclusion which I reach. That court held that the required quarterly investments in Class C stock were payments for capital assets. It affirmed the holding of the District Court⁴ that the payments were not interest, and reversed the holding that they were ordinary and necessary business expenses. In so doing it considered *Penn Yan Aquway Cooperative v. United States*, 417 F. 2d 1372 (Ct. Cl. 1969) and the District Court opinion in the present case and would not follow them.⁵

1.

Central to this case is the fact that the New Orleans Bank for Cooperatives is itself a cooperative. "A cooperative is an association which furnishes an economic service without entrepreneur profit and which is owned and controlled on a substantially equal basis by those for whom the association is rendering service. . . . '[E]ntrepreneur profit' . . . really represents the antithesis of the benefits normally ascribable to cooperatives. 'Entrepreneur profit' is used in the true economic sense of a return for the speculative or risk element in an enterprise. In a cooperative, all the members assume, in a broad sense, the economic risk, and they contemplate no return for the undertaking of the risk." Packel, *The Law of Cooperatives*, § 1, p. 2-3 (3d ed.).

"The primary objective of an ordinary cooperative is not charitable. . . . In the normal case . . . the cooperative is designed to further the economic interest or welfare of its members. Economic welfare does not merely refer to financial savings or increased monetary returns. It cuts much deeper and takes into consideration basic aspects of economic life. Quality

⁴ *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo. (1968)).

⁵ *Penn Yan* held that the purchase price of Class C stock was interest to the extent that it exceeded \$6.60 per share, which the taxpayer conceded was its value.

of product, decency of service, ownership, control and satisfaction of self-help are important benefits of cooperatives and sometimes are even more important than the direct financial benefits." *Id.* at pp. 6-7. Among the normal attributes of a cooperative are:

- (3) transfer of ownership interests is prohibited or limited;
 - (4) capital investment receives either no return or a limited return;
 - (5) economic benefits pass to the members on a substantially equal basis or on the basis of their patronage of the association;
- Id.* at 3.

Justice Brandeis pointed out in his dissent in *First v. Corporation Commission*, 278 U.S. 515, 536, 73 L.Ed. 483, 495 (1929) that farm cooperative seek, in addition to the immediate and direct financial advantage of members, a type of economic democracy as well in which there is equitable assumption of responsibilities and equitable distribution of benefits, and that in addition to financial benefits they promote and effect cooperation among farmers. These objectives, coupled with that of economic strength springing from the combination in a single institution of the combined effort and contributions of all, is important in grasping the relationship between the appellant cooperatives and the cooperative financial institution from which they borrow.

2.

As Professor Nieman points out, the capital of a cooperative, insofar as permanence or impermanence of shares of stock or other units of capital is concerned, is essentially different from the capital of other business corporations.⁶ The commercial shareholder does not anticipate his contribution to capital will be returned to him until dissolution. Prior to dissolution he can recover his contribution by selling his shares to another.

A cooperative's capital, however, more often represents essentially a loan or temporary contribution by its patrons to finance certain economic services for them.

⁶ Nieman, *supra*, at 393.

The patron-member or patron-shareholder expects that the capital which he contributes will be returned to him prior to dissolution, but not until his own and other patrons' subsequent contributions to capital render his earlier contribution unnecessary to finance the cooperative's facilities and operations. He does not expect to wait until dissolution, and he knows that his shares are not readily salable. He looks to the cooperative to return his capital contributions to him if, and as soon as, it can do so.

Nieman, supra, at 393-94. This concept is a formalization of early, informal cooperative arrangements.⁷ As cooperatives became more permanent and more continuous in their operations the patron who temporarily put his capital at the service of the group, footnote 7, *supra*, no longer took it home with him when his transaction was over but left it for the use of the continuing activity, though not for its permanent use. But the bedrock principle remained that he received no return or a limited return on his investment in capital.

Most of the formalized early cooperatives were corporations, which organized and structured their capital under the general corporation laws, the only laws available, though unrelated to the particular capital requirements of the cooperative. *Id.* at 393 and 395. "There ever since has been a trial-and-error effort to develop for cooperatives a kind of capital more adequately suited to their peculiar needs and still within the corporate form." *Id.* at 395.⁸

⁷ "When more than a century ago, a group of Ohio farmers joined together to ship their cattle to market at Pittsburgh, each of them presumably furnished his share of the cattle, wagons, and equipment which were the capital for the expedition; and each participant's capital was returned to him upon the completion of the project. The horses, wagons, machinery, and labor required for barn raisings or threshing were furnished by the participants, and were returned to them after each job or threshing season. Each participant ceased to provide such capital, and capital previously furnished was returned to him, when he ceased farming and, thus, no longer had need for the barn-raising or threshing services and equipment of his neighbors. In such informal, cooperative enterprises, the temporary nature of the capital employed was plain."

Id. at 394.

⁸ Today, in most jurisdictions, a cooperative can incorporate either with or without capital stock. Packel, *supra*, § 5(c) at p. 35.

As cooperatives evolved, necessity imposed the creation of a new kind of temporary or interim capital, revolving fund capital.

Provision frequently was made for the return of a member's share of the capital upon the termination of his membership. The risk to the cooperative's financial integrity in the event that a substantial number of members should withdraw and demand the return of their membership capital at the same time required modification of the right to demand a return of membership capital promptly upon termination of membership. Provision was made to suspend the rights and privileges of membership or to retain the member's share of the capital until such time as the cooperative should be financially able to pay it out without undue prejudice to other members or creditors. The problems incident to the existence of permanent capital, even membership capital repayable upon termination or suspension of membership or reasonably soon thereafter, eventually, were met by the creation of a new kind of temporary or interim capital which has now become quite common, although peculiar to cooperatives—that is, revolving-fund capital.

Id. "The revolving fund plan has been likened to a water wheel, picking up water, using it to create the power that turns the mill machinery, and returning the water to the mill-stream." *Id.* at 396. As the fund of capital becomes adequate it is maintained at that level by continuing to receive each year new contributions to capital by current patrons, and to the extent that new contributions increase the capital above that needed the excess is returned to the patrons who made the earliest contributions. Necessarily there is some awkwardness in the use of shares of stock in a cooperative with revolving capital, but these are tempered by employing different classes of shares. *Id.* at 398-402.

The relationship of the stock cooperative to the member-stockholder who contributes capital is not strictly debtor-creditor, for there is no loan with a maturity date, nor corporation-shareholder in the commercial sense. Though styled corporation-shareholder it is in fact *sui generis*. Nieman, *supra*, at 397 and 402.

3.

It is against this background of recognized principles of cooperative organization and operation that Congress has estab-

lished a comprehensive farm credit system, which is but a part of a broader program of encouraging the organization and development of effective cooperatives.⁹ The cornerstone was the Federal Farm Loan Act of 1916,¹⁰ establishing the federal land banks with goals of providing low cost farm credit, promoting farmer ownership of the banks, and established and stimulating among farmers cooperative effort.¹¹ Farmers could not borrow directly but were required to form national farm loan associations, which, operating on cooperative principles, would serve as middlemen in securing loans. These cooperative associations were required to purchase stock in the federal land banks in amounts relating to the size of loans (5 per cent of face.)¹²

The Farm Credit Act of 1933¹³ established a much broader structure of farm credit around the original twelve federal land banks. Among the new institutions were the Central Bank for Cooperatives and twelve regional banks for cooperatives which had the specific function of lending to farmers' cooperatives. The initial capital, comparatively nominal, was furnished by the United States in the form of \$110 million, divided between the twelve regional banks and the Central Bank.¹⁴ Each regional bank had but one class of stock. Each borrowing cooperative had to become a member of the regional cooperative bank and a contributor to its capital by purchasing stock (or subscribing to a guaranty fund) in an amount related to the size of his loan. The purchase price of the stock was paid when the loan was closed, either by being deducted from the proceeds or added to the amount of the loan. However, upon repaying his loan a borrower could withdraw his contribution to capital by demanding redemption of his stock. These withdrawals caused the capital funds remaining in the banks to be insufficient to permit them to operate on a sound basis and to

⁹ Packel, *supra*, § 60, p. 275 et seq.

¹⁰ 39 Stat. 360.

¹¹ S. Rep. No. 144, 64th Cong., 1st Sess. pp. 2, 4 and 10.

¹² The Senate Report said of this requirement:

"At the outset we secure the personal interest of the borrower by requiring him to contribute to the capital of the loan association 5 per cent of the face of his loan. This personal stake makes the . . . borrower a cooperator."

S. Rep. No. 144, *supra*, p. 10.

¹³ 48 Stat. 257.

¹⁴ 2 U.S. Code & Admin. News 1955, p. 2949, at 2950.

meet the needs of the farmer cooperatives for credit.¹⁵ This is the difficulty which, as Professor Nieman points out, gives rise to revolving fund capital. In 1955 Congress changed the capital structure of the 12 regional banks and the Central Bank for Cooperatives to the revolving fund system.

The Farm Credit Act of 1953 required a study of methods by which to effect increased borrower participation in the management, control, and ultimate ownership of institutions operating under the permanent system of agricultural credit available through the Farm Credit Administration. 2 U.S. Code & Admin. News 1955 at 2947, 2949. The Farm Credit Act of 1955, 69 Stat. 655, which overhauled the entire system of farm credit, was the result of that study. The Senate Committee reported that the House Bill (in no relevant aspect different from the Senate Bill or the Act as passed) "would be a forward step in the goal of having private borrowers owning and managing these credit agencies." *Id.* at 2948.

The House Committee Report described the purpose of the legislation in this way:

The primary purpose of title I of the bill is to provide a plan under which the banks [for cooperatives] would be organized on a truly cooperative basis. Borrowing cooperatives would continually make capital contributions to the system so long as they used its credit service. Each year final net savings (after taxes, dividends, reserves, and surplus requirements) would be distributed as patronage refunds to borrowing cooperatives in the form of capital stock, all of which capital would remain in the system until all of the capital stock of the United States had been retired. Each year Government capital would be retired in an amount equal to the required stock contributions or and the patronage refunds to the borrowing cooperatives.

Id. at 2951.

The Act established a pure revolving fund capital structure, *Penn Yan*, *supra*, 417 F. 2d at 1374. It created Classes A, B and C stock, A owned by the government (nonvoting and no dividends); B owned by investors (nonvoting but dividend paying); and C (voting but only one vote to a member, no

¹⁵ 2 U.S. Code & Admin. News 1955 at 2951; *Penn Yan*, *supra*, at 1374.

dividends), 12 U.S.C. § 1134d. Each year, as capital is added through investment in Class C shares by each borrower, and through distribution to borrowers of patronage refunds in the form of Class C shares, an equal amount of Class A shares is retired. Retirement of Class C shares will commence when all Class A stock has been retired, except that as Class C is retired all earlier issued Class B must also be called for retirement.¹⁶ There is no retirement of stock on demand.

In lieu of the one-time purchase of stock previously required of each borrower, the 1955 Act substitutes a system of scheduled purchases of Class C stock. "[E]ach borrower . . . shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum . . . of the amount of interest payable by it to the bank during the calendar quarter. Payment for such stock shall be made quarterly or when the regular interest payments of the borrower are payable." 12 U.S.C. § 1134d(a)(3). Prior to the 1955 Act required purchases were unrelated to interest but keyed to the amount of the loan. Post-1955 purchases are keyed to interest only as a measure of the amount of stock to be purchased. It is obvious that they are keyed to payments of interest for convenience of billing and payment—the borrower pays his scheduled contribution to capital when he makes his interest payment, whether quarterly or otherwise. Amounts due for interest and investment in stock are rendered in the same bill, although separately stated and identified. A borrower who owns Class B stock and does not want to make the required investment in Class C stock by paying cash can convert his Class B to Class C 12 U.S.C. § 1134d(a)(3). This has been done by the New Orleans Bank in many instances, always on a dollar-for-dollar basis, \$160 par value of Class C for \$100 par value of Class B.^{16A}

¹⁶ The Class B shares are of nominal importance. In 1963 they constituted only approximately 5 per cent of total stock outstanding in the New Orleans Bank.

^{16A} The necessity of not being hypnotized by the phraseology of the commercial corporation is pointed up by 12 U.S.C. § 1134d(b). If a borrower is not authorized under the law of the state of its organization to take stock in the bank, it must deposit in the "guaranty fund" of the bank the amount it would have invested in stock. This is the contribution to capital by the cooperative patron in its pure sense, unencumbered by share of stock con-

Pre-1955 stock can be converted to Class B or Class C. This has been done on the same basis of dollar for dollar of par value. Some holders of pre-1955 stock have been allowed to apply the full par value thereof against their loans outstanding.

The bank has a statutory lien on the borrower's Class C stock. In cases where it has been exercised against a defaulting borrower, the full par value of the stock has been applied to the loan balance.

In 1956, promptly after the 1955 Act went into effect, the New Orleans Bank established 15 per cent of interest payable during the quarter as the amount of quarterly investment in stock required of the borrower. It did so pursuant to a policy determination that it hoped to retire all Class A stock by 1976, a 20-year period, and projected the 15 per cent figure as sufficient to achieve that. Retirement has been carried out each year as planned except that the rate of retirement has been better than expected. By 1963 Class A stock had been reduced from the 1956 level of \$7,000,000 to \$4,880,000, as against the projected level for that year of \$5,150,000. In 1966 the Bank estimated informally that all Class A stock would be retired by 1972 or 1973.¹⁷

4.

Purchase of a single Class C share is a prerequisite to eligibility to borrow from the bank, 12 U.S.C. §-1134d(a)(3). The District Court, the majority in this case and the court in *Penn Yan* viewed the purchase of this single share as conferring upon the purchaser the full spectrum of benefits that could flow to it from stock ownership, so that no additional benefit could accrue by its securing a loan and, as an incident thereof, purchasing additional stock as required. This misses the whole point of the cooperative structure of the banks. The thrust of the Congressional scheme is the promotion of permanent institutions to supply low cost credit to farmers' cooperatives and to

ceptualism. Patronage refunds to such a borrower are credited against its contributions to the fund. Its deposit is returned to it in the same manner as Class C stock is redeemed.

¹⁷ The supplemental brief of the United States quotes from an exhibit in the M.F.A. record which states that five of the regional banks have retired all Class A stock and that it is anticipated that all others will accomplish full retirement of the government's investment by 1971.

foster the creation of additional cooperatives.¹⁸ Ownership of the bank ultimately will be in the cooperatives. They will also participate in management, to the extent of the private sector of the joint government-private management scheme. A purchase of Class C stock does not increase the capital of the bank or its current lending capacity, since Class A stock in a like amount is retired. But each purchase moves the bank toward its ultimate institutional status as a farmer-owned cooperative supplying low cost farm credit to these taxpayers and others like them. The government "primed the pump" by "revolving in" the initial capital of a joint government-private undertaking, the societal values of which it is not the judicial function to question, and from which the government's capital was designed ultimately to be wholly "revolved out." To view the process of replacing government capital by private capital, as do taxpayers as producing no benefit to anyone except the government which gets its money back, is to misunderstand both the purpose of Congress and the institutional value of the cooperative bank to the cooperatives which will own it and borrow from it.¹⁹

There are institutional values other than that of continued availability of low cost credit. There is the inherent cooperative concept that it is beneficial to channel into a single integrated effort the assets and needs of the group of patrons. There is the benefit of simple economic power, through ultimate substantial ownership of the established, fully capitalized, staffed, and accepted financial institution.^{19A}

¹⁸ The 1963 report of the New Orleans Bank states that more than half of the cooperatives regularly financed by it are the outgrowth of conferences held by its staff with groups of farmers contemplating the establishment of new cooperatives.

¹⁹ The benefit to these taxpayers, of the New Orleans Bank as a source of low cost credit, is quickly seen by a look at the years here in question. Their purchases of Class C stock for these years were, in round figures: Coastal (1958-63)—\$11,700; \$33,900; \$47,400; \$41,700; \$35,000; and \$42,100. Mississippi (1961-63)—\$18,900; \$16,800; and \$19,300. Each purchase represents 15 percent of the interest paid for the year. Interest usually was between 4 and 5 percent. A simple calculation reveals the massive extent of the loans which they were enjoying. From its organization through fiscal 1963 the New Orleans Bank made loans to its limited class of borrowers in its region (Louisiana, Mississippi and Alabama) of more than 618 million.

^{19A} Also it should be noted that the major source of loan funds for each bank is not its capital but funds which it obtains by borrowing from the

Other benefits are perhaps more easily perceived because in the more conventional garb of dollars. As borrowers, taxpayers qualify for patronage refunds, distributed to them annually in proportion—as in all cooperatives—to their use of the services offered, thus in this instance measured by interest paid. In 1958–63 Coastal received patronage refunds in Class C stock of \$289,309.81. In 1961–63 Mississippi received \$81,272.57. Together these are 14 percent of *all* Class C stock (purchases and refunds) outstanding at the end of fiscal 1963. When their purchases of Class C stock for those years are added, it is revealed that together the taxpayers owned 24 percent of the outstanding Class C stock.

Also each bank allocates on its books each year to each patron, in proportion to interest paid by the patron, a portion of the amount by which the bank's contingency reserves exceed its needs.²⁰ For the same years as above, Coastal was allocated from surplus \$127,748.62, Mississippi \$35,771.48. This "allocated surplus" eventually is distributed in the form of Class C shares.²¹ The patronage refunds and the allocated surplus are not a return of the borrower's contributed capital but distributions of earnings, not presently convertible to cash but in due course "revolved out" of the cooperative capital into cash to the borrower.

These benefits are measured by the borrower's use of services. But he does not qualify for them by the act alone of borrowing, only by borrowing plus contributing to capital. Congress could have chosen other approaches. A large contribution to capital to become eligible for service was a possibility, but this would be inconsistent with the cooperative concept of nominal financial outlay to become a patron (a small membership fee for the nonstock cooperative, a small purchase of stock for the stock cooperative), with the real and substantial contribution to capital made in proportion to use of services. It would be incon-

Central Bank and the federal intermediate credit banks and by sale of debentures in cooperation with other regional banks. This access to low cost funds, and government-assisted credit, continues after Class A stock is repaid.

²⁰ Included therein are like distributions which the regional bank receives from the Central Bank for cooperatives.

²¹ The separate increments of value represented by the Class C stock (purchased and patronage refunds) and the allocated surplus are pointed out in *Columbia Bank for Cooperatives v. Lee*, 368 F.2d 934 (4th Cir. 1966).

sistent with the aim of fostering organization and growth of fledgling cooperatives. Congress could have required a large one-shot contribution when the loan is made, but it had discovered the disadvantages of this before 1955. It could have provided for adding to capital by higher interest rates carried forward into earned surplus, but this would be inconsistent with its purposes of offering low rates and at the same time shifting from government to private ownership through the normal revolutions of revolving fund capital.

5.

The *sui generis* stock of an incorporated cooperative need not have the same characteristics as ordinary commercial stock to be a capital asset. But the differences loom so large in the minds of the plaintiffs, of the District Court²² and the majority in this court that brief comment is appropriate.

No Class C stock certificates are issued. A form for the certificates has been approved by the Farm Credit Administration, but the Board of Directors of the New Orleans Bank exercised the discretion given them by the bylaws not to issue certificates. The Bank reflects on its stock ledger the amount of each type of Class C stock owned and at the end of each fiscal year notifies each owner of the amount owned at the beginning and end of the year.²³

The stock has no dividend and no growth potential. This is normal for a cooperative.

Only the first share of Class C stock carries a voting right. "One person one vote" is a basic cooperative principle, which

²² The District Court, after emphasizing the differences, concluded that the stock "does not enjoy the usual attributes of shares of stock but are mere bookkeeping entries or devices." The District Court made no references to the peculiarities of cooperative financing. In fact its opinion does not even reveal that the New Orleans Bank is a cooperative.

²³ This system of recording stock ownership without issuing certificates is no surprise to any holder of shares of almost any one of the major mutual funds which employ the same method for shareholders authorizing automatic reinvestment of dividends and which, like the New Orleans Bank, notify the shareholder periodically of how many new shares he has acquired.

A certificate of stock is not the stock itself but only evidence of ownership. The rights and duties between corporation and stockholder exist apart from the certificate. 11 Fletcher, Corporations, § 5092 (Perm. ed.).

gives recognition to the concept of an economic democracy. Packel, *supra*, at 138-40.²⁴

Class C shareholders will not enjoy sole control of the bank in the commercial sense even when all Class A stock is retired since they will not elect all directors of the joint board which administers it and other farm credit agencies of the region. This makes the stock different from some commercial stock²⁵ but no less a capital asset.

The stock is not²⁶ transferable except to other cooperatives and with the consent of the Bank.²⁶ This is usual in a cooperative. Packel, *supra*, pp. 3, 127. It is essential to keep out of the membership persons with interests antagonistic to the cooperative and is an effective means to keep patrons from transferring their interests at a profit. *Id.* at 127-128, and cases there cited.

6.

The majority center on, and repeatedly employ, the phrase "interest override" and even characterize the requirements of the statute in those terms. The term nowhere appears in the statute, the Congressional history, the loan agreements, or the quarterly bills sent taxpayers showing separately interest, principal and "C stock subscription." The President of the New Orleans Bank explained that the term had grown up in that regional bank and in turn had been picked up by its borrowers.

Class C stock purchased under the required investment provisions is shown in the stock ledger separate from that issued as patronage dividends, and under the heading "Investment in C Stock (Interest Override)." The President defined "interest override" as "the amount we require our borrowers to pay over and above interest for the purchase of C stock."

²⁴ The principle is carried forward into the Capper-Volstead Act under which a cooperative marketing association, if it wishes to enjoy immunity from the Sherman Act, must not allow a member more than one vote regardless of how much stock he owns. 7 U.S.C. §§ 291-292.

²⁵ Commercial preferred stock often is nonvoting, and nonvoting common of many companies is traded daily on the stock exchanges.

²⁶ There have been a few approved transfers incident to liquidation, merger or accommodation between cooperatives.

But compare *Columbia Bank for Cooperatives v. Lee*, 308 F.2d 934 (4th Cir. 1966), stating that once issued Class C Stock is transferable to any person.

The promissory notes signed by taxpayers provide for interest. Each separate loan agreement provides:

Stock Purchase: The association shall invest quarterly in Class C stock of the bank at its fair book value, not exceeding par, an amount equal to 15 percent of the amount of interest payable by the association to the bank on said loans for said calendar quarter or part thereof. The association shall pay for said Class C stock on the date interest is due and payable. . . .

7.

The plainly erroneous rule applied to the finding of the District Court that the Class C stock has only nominal value, may not be the basis of an affirmance. What has been said makes clear that the stock has, as the Eighth Circuit concluded in *MFA*, an intrinsic value. Also it is apparent that the District Court's finding was based on the erroneous basis of comparing the stock, characteristic by characteristic, with that of the usual commercial corporation and totally overlooking its value as a capital contribution to a cooperative under the plan of the Congress.

On the issue of value, in *Columbia Bank for Cooperatives v. Lee*, 368 F. 2d 934 (4th Cir. 1966), a bankrupt cooperative owned Class C stock of the Columbia regional bank with a par value (in round figures) of \$54,200, Class B stock with a par value of \$45,800, and there had been allocated to the bankrupt surplus of \$13,000, total \$113,000. The referee ordered the bank to allow a setoff of this \$113,000 against the cooperative's indebtedness to it of \$162,000, and the District Court affirmed.²⁷ Another cooperative had offered to buy the stock for \$50,000, which was 45 percent of its par value and allocated surplus. The Fourth Circuit held that the bank was not required to offset at par value and remanded for valuation by the referee. It declined to accept the single offer of \$50,000 as a reasonable reflection of true value and noted: "However thin the general market for these shares may be the continuing stream of borrowers from the bank provides it with a ready market." 368

²⁷ The New Orleans Bank in many instances has made just such a full offset without legal proceedings.

F. 2d at 940.²⁸ The Columbia Bank projected retirement of all Class A stock by 1967. New Orleans Bank stock may be worth less than 45 cents on the dollar because of the difference between projected 1967 retirement of Class A and projected 1972-1973 retirement. But the discount is not to \$1.00 per share or less. In the present case an expert familiar with cooperative financing presented a full and careful analysis of Class C stock of each year separately and assigned values ascending from \$3.42 per share for 1958 Class C stock to \$38.65 per share for that of 1963.

8.

My brothers have, in Professor Neiman's terms, felt the leg of the elephant and concluded that the beast is interest. A look at the concept of cooperatives, the legislative history, the expressed intent of Congress, the language of the statute, the books and records of the parties and the loan agreements signed by the taxpayers, reveals that it is an elephant after all. I would join with the Eighth Circuit and would reverse.

²⁸On remand (not officially reported) no valuation by the referee was necessary. The parties agreed that the trustee would receive a credit in the amount of the value of bankrupt's stock plus allocated surplus, a total of \$112,094.97, and the trustee agreed to pay the bank cash of \$49,305.03, which was the balance of the bank's claim.

JUDGMENT

United States Court of Appeals for the Fifth Circuit

October Term, 1969

No. 28271

D.C. Docket No. CA 1213 and 1214

MISSISSIPPI CHEMICAL CORPORATION,

PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDENT-APPELLANT

COASTAL CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeal from the United States District Court for the
Southern District of Mississippi*

Before GEWIN, GODBOLD, and CLARK, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Mississippi, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that defendant-appellant pay to plaintiff-appellee, the costs on appeal to be taxed by the Clerk of this Court.

SEPTEMBER 14, 1970.

Issued as Mandate: October 6, 1970.

A true copy:

Test:

EDWARD W. WADSWORTH,
Clerk, U.S. Court of Appeals, Fifth Circuit.

By CLAUDETTE STAIGER,
Deputy.

New Orleans, Louisiana, October 6, 1970.

Supreme Court of the United States

No. 1082—OCTOBER TERM, 1970

UNITED STATES, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

Order Allowing Certiorari. Filed February 22, 1971

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted.

Mr. Justice Blackmun took no part in the consideration or decision of this petition.

(375)

70-52

No. —

In the Supreme Court of the United States

OCTOBER TERM, 1970

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

ERWIN N. GRISWOLD,

Solicitor General,

Department of Justice,

Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1970

No.

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The memorandum opinion of the district court (Appendix A, *infra*, pp. 5-10) is not reported. The majority and dissenting opinions of the court of appeals (Appendix B, *infra*, pp. 11-44) are not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on September 14, 1970 (Appendix C, *infra*, pp. 45-46). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the respondent cooperatives' investments in the Class C stock of the New Orleans Bank for Cooperatives, purchased in connection with loans secured from that Bank, were expenditures for capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

The pertinent provisions of Sections 162, 163 and 1221 of the Internal Revenue Code of 1954 are set forth in Appendix D, *infra*, pp. 47-48.

STATEMENT AND REASONS FOR GRANTING THE WRIT

This case presents the identical issue raised in *M.F.A. Central Cooperative v. Bookwalter*, 427 F. 2d 1341 (C.A. 8), taxpayers' petition for a writ of certiorari pending, No. 824, this Term, in which the government has recently joined in urging that the petition be granted.¹ The court below held that payments made by the respondent cooperatives for Class C stock of the New Orleans Bank for Cooperatives, in connection with loans obtained from that Bank, were deductible as interest under Section 163 of the Internal Revenue Code. In so holding, the court followed the earlier decision of the Court of Claims in *Penn Yan Agway Cooperative, Inc. v. United States*,

¹ Copies of our memorandum in *M.F.A. Central Cooperative* are being served on counsel for respondents herein.

417 F. 2d 1372.² In *M.F.A. Central Cooperative*, the Eighth Circuit held that such payments made by co-operatives for the Class C stock of the St. Louis Bank for Cooperatives were not deductible either as ordinary and necessary business expenses under Section 162 of the Code or as interest under Section 163, because the stock constituted a capital asset within the meaning of Section 1221.³ As set forth in our memorandum in *M.F.A. Central Cooperative*, the question on which the courts of appeals and the Court of Claims are in conflict is fiscally and administratively important, and thus warrants review by this Court.

CONCLUSION

If the Court grants the petition in *M.F.A. Central Cooperative*, as we urge it should, we suggest that action on the instant petition be deferred pending the outcome of that case, and that this case be disposed

² The Class C stock in each of these cases was purchased at par value of \$100 per share. In the instant case the court of appeals affirmed the holding of the district court permitting respondents to deduct the entire purchase price of the stock beyond a \$1 nominal value assigned to each share. In *M.F.A. Central Cooperative* the district court found that the stock had no market value and permitted a full deduction of the purchase price. In *Penn Yan Agway*, the Court of Claims found a \$7 value and permitted a deduction for the remaining \$93.

³ Neither the Court of Claims in *Penn Yan Agway* nor the court below passed directly on the question whether payments for Class C stock could be deducted under Section 162.

of in accordance with the decision in *M.F.A. Central Cooperative*.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

DECEMBER 1970.

APPENDIX A

United States District Court, Southern District of
Mississippi, Western Division

CIVIL ACTION NUMBER 1213

MISSISSIPPI CHEMICAL CORPORATION, PLAINTIFF

7 v.

UNITED STATES OF AMERICA, DEFENDANT

CIVIL ACTION NUMBER 1214

COASTAL CHEMICAL CORPORATION, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

These consolidated suits seek a recovery of income taxes back-assessed and paid for the fiscal years (ending June 30) 1961, 1962 and 1963, and for the additional years 1958, 1959 and 1960 as to Coastal Chemical Corporation. The plaintiffs are Mississippi corporations created as cooperative associations as defined in the "Agricultural Marketing Act" as amended.¹ The New Orleans Bank for Cooperatives had Class A stock, Class B stock (neither of which is involved in any way in this suit), and Class C

¹ 12 U.S.C.A. Sec. 1141 et seq.

stock (owned by these cooperatives) which gives rise to these suits by reason of the divergence of opinion as to the fair market value of such Class C stock during the tax years stated.

The qualities and attributes and rights accorded the holder of such Class C stock is regulated by statute² and is committed to the ultimate control of the New Orleans Bank for Cooperatives.³ The plaintiffs were not eligible to borrow funds from the cooperative bank without owning a qualifying share of such Class C stock. The bank required these cooperatives to purchase from it 15% of the amount of each interest payment made quarterly on its loan in exchange for shares of said stock credit at one hundred dollars per share par value. These shares of stock were carried on the plaintiffs' books at one dollar per share and were actually considered and

² It is interesting, if not somewhat persuasive, to notice that tax decision No. 6428 (December 2, 1959) following *Long Poultry Farm, Inc. v. Commissioner of Internal Revenue* (4CA) 249 F. 2d 726 and *Commissioner of Internal Revenue v. B. A. Carpenter*, (5CA) 219 F. 2d 635 in dealing with a cognate question as to market value of a document payable only in the discretion of a cooperative association "or which is otherwise subject to conditions beyond the control of the patron, shall be considered not to have any fair market values at the time of its receipt by the patron, *unless it is clearly established to the contrary*." The existence of market value or even actual value of this Class C stock as stock is not clearly established by the facts and circumstances in this case. The proof here is to the contrary.

³ The Class C stock can be retired at par without interest, but not until all government Class A stock has been retired, and all Class B stock has been retired which was issued during or prior to the year in which such Class C stock was issued and until all prior issued Class C stock has been retired. This may be done in the discretion of the Board of Directors of the bank and subject to the approval of the Farm Credit Administration.

treated as having no value during the period in suit. These forced purchases of such stock were authorized by 12 U.S.C.A. Sec. 1134d(a)(3). Periodically, the bank issued these plaintiffs certificates of credit for additional shares of Class C stock at the end of each year as "patronage refunds," as authorized by 12 U.S.C.A. Sec. 1134l(b), effectually as refunds of overcharges in the processing of such loan.* Significantly, no certificates of Class C stock were ever issued by the bank, but the plaintiffs were simply notified of credit on the bank books therefor. None of this stock has ever been sold by any cooperative. Only a cooperative can hold such stock. No provision is made for its redemption or retirement, except by statute as to order of retirement with the Class A and Class B stock. The United States owns all of the Class A stock, and the bank has absolute control over such stock and no provision has been made, or can be made for any retirement of Class C stock until all Class A stock and outstanding Class B stock is retired. Regardless of the number of shares of Class C stock owned, the plaintiffs have only one vote as owner of Class C stock. If a borrower's account with the bank is inactive for as long as two years, the right to vote such stock is abated.

The Class C stock has no growth value and can be retired at par without interest. No dividend is paid on such stock. It may be readily seen that this Class C stock as a practical matter does not enjoy the usual attributes of shares of stock, but are mere book-

*The "patronage refund" is not income but simply a refund of an overcharge of interest. *New York Life Insurance Co. v. Anderson, Internal Revenue Collector*. (2CCA) 263 Fed. 527, cert. denied 41 S.Ct. 536 holds: "Excess premiums collected by a mutual insurance company and returned to stockholders or applied to their credit, do not constitute income of the company within corporate excise tax act."

keeping entries or devices set up by the bank for the processing of loans to cooperatives. While the plaintiffs received certificates of credit on the books of the bank for Class C stock, some by purchase and other credits as statutory "patronage refunds," there is actually no significant difference in such Class C stock acquired in such different ways. It is a universal rule of law, applicable to such Class C stock credits, that any charge by whatever name called, or device employed as an exaction for or a condition precedent to a loan of money is interest.⁵ These plaintiffs did not voluntarily invest any money in any Class C stock of the bank, but did contribute funds to the bank which it carried on its books as credit for said stock solely as an exaction by the bank without which such loans would not have been made by the bank. These credits were interest items incurred by these plaintiffs and not capital investments. The credits for Class C stock purchased were clearly disbursements for interest as a matter of law and the credits as "patronage refunds" were not income but were refunds of overcharge as interest. These plaintiffs simply owned letter credits showing as credits on the books of the bank, that they (plaintiffs) owned so many shares of Class C stock, without ever having actual possession at any time of any share or certificate of such Class C stock. Clearly, such Class C stock owned by the plaintiffs could not possibly have any appreciable market value under such circumstances and

⁵The act of Congress (12 U.S.C.A. Sec. 1141f) limits the interest rate on such loans to 6%. Regardless of how such a charge for the use of money is characterized, the universal rule is that interest is: "The amount which one has contracted to pay for the use of borrowed money, *Old Colony R. Co. v. Commissioner of Internal Revenue*, 284 U.S. 552, 52 S. Ct. 211." or "compensation for the use or forbearance of money." *Deputy v. Du Pont*, 308 U.S. 488, 60 S. Ct. 363.

conditions, coupled with the statutory restrictions on said class of stock.

These plaintiffs made timely and proper demand for refund and made known the basis therefor, and this Court has full jurisdiction to that which is herein done.

In sum, this Class C stock acquired by the taxpayers during the years in suit did not represent voluntary investments. The plaintiffs were forced to purchase stock at each quarter interest paying date equal to 15% of each interest payment. This obligation had to be satisfied by money, and could not be satisfied by Class C stock already owned. The Class C stock whether acquired by purchase or "patronage refund" was the same, and represented interest refunded or money paid for the use of money lent by the bank. This stock was not worthless, but had merely a nominal value because of the unusual attributes stated. The value of such stock arrived at by applying the prevailing discount rate on a hundred dollar par value certificate, not bearing interest and not producing dividends, to be revolved or retired at some indeterminate period of time in the future (not less than twenty years or before 1989) would not have any market value, but would nevertheless have only a nominal value of not more than one dollar per share. The ninety-nine dollars remaining in the par value of this Class C stock owned by these plaintiffs was deductible by them as interest during the tax years involved. The plaintiffs are accordingly entitled to a judgment against the defendant for such amounts indicated, with statutory interest. No cost will be assessed. A copy of this opinion shall be filed in each case separately as embracing the finding of facts and conclusions of law therein.

A separate judgment accordingly may be presented for entry in accordance with this opinion in each of these cases.

FEBRUARY 14, 1969.

[s] HAROLD COX,
United States District Judge.

APPENDIX B

In the United States Court of Appeals
for the Fifth Circuit

No. 28271

MISSISSIPPI CHEMICAL CORPORATION,
PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT.

COASTAL CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeals from the United States District Court for the
Southern District of Mississippi*

(September 14, 1970)

Before GEWIN, GODBOLD and CLARK, Circuit Judges.

GEWIN, Circuit Judge: The government appeals from separate judgments entered for Mississippi Chemical Corporation and Coastal Chemical Corporation (hereinafter, taxpayers) in their suits for refund of federal taxes. Taxpayers based their claims

for refund on the contention that \$99 of each \$100 expended for the purchase of certain Class C stock in the New Orleans Bank for Cooperatives constituted deductible expenses in the year of purchase. The government contended that these amounts were the non-deductible costs of acquiring capital assets. The district court concluded that the payments were deductible as interest expenses, and we affirm.

Taxpayer's are Mississippi corporations with their principal place of business in Yazoo City, Mississippi. During the tax years in question they were "cooperative associations" as defined in the Agricultural Marketing Act.¹ Taxpayers are stockholders in, and borrowers from, the New Orleans Bank for Cooperatives (hereinafter, the Bank). The Bank is part of a banking system created by the federal government² during the depression to provide low cost loans to farmer's marketing, purchasing, and service cooperatives. It is one of the twelve regional banks in the system and serves Louisiana, Mississippi, and Alabama.

The governing legislation³ provides for three classes of stock in a regional bank. Class A stock represents the original capital contributed by the United States. These shares are non-voting and pay no dividend. The legislation contains a scheme of retirement for Class A shares which is dependent on the amount of Class C stock purchased and on the net profits of the regional bank. Class B stock may be issued to any person. It is non-voting but may bear a dividend not to exceed four percent per annum. Class C stock may only be issued to banks for cooperatives and to farmers' cooperative associations. It pays no dividend. Each holder of Class C stock is entitled to

¹ 12 U.S.C. § 1141(j).

² 12 U.S.C. § 1134.

³ 12 U.S.C. § 1134(d).

one vote, though a cooperative has only the single vote regardless of the number of Class C shares held.

Farmers cooperatives, like taxpayers, acquire Class C shares in three ways: (1) Each cooperative must purchase a qualifying share of Class C stock to be eligible to borrow from the Bank. (2) A borrower cooperative is required to make quarterly investments in Class C stock; these purchases are referred to as "interest override" payments. The amount required to be invested is not less than ten nor more than twenty-five percent of the interest payable by the borrower for that quarter, to be determined by the Bank's directors.⁴ (3) Class C stock is also received by farmer's cooperatives as a distribution of the Bank's net profits during a fiscal year. These distributions, called "patronage refunds", are computed in amount "in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year."⁵

Mississippi Chemical Corporation acquired its qualifying share of Class C stock in 1956; Coastal Chemical Corporation purchased its share in 1957. Each carried its initial share on its books at the \$100 cost, and neither sought a deduction for any part of this expense. These qualifying shares were not involved in the suit below.

Mississippi Chemical's suit concerned the fiscal years ending 30 June 1961, 1962, and 1963. As a result of its borrowings during those years it was required to make "interest override" purchases of 189, 169, and 193 shares of Class C stock respectively. The purchase price of each share of stock was \$100. In

⁴ The rate for the New Orleans Bank during the periods in question was 15%.

⁵ 12 U.S.C. § 1134(1)(b).

its tax returns for each year, Mississippi Chemical reported \$1 per share as the cost of acquiring a capital asset and claimed a deduction in the amount of \$99 a share as an interest expense. In the same fiscal years, Mississippi Chemical received "patronage refunds" of 287, 275, and 251 shares of Class C stock respectively. It reported \$1 per share of the "patronage refund" as a reduction of interest expense and investments, but it made no report of the remaining \$99 of par value of each share.

Coastal Chemical's suit involved a longer period of time including the fiscal years ending 30 June 1958 through 1963. In these years Coastal Chemical purchased 118, 339, 473, 417, 351, and 421 shares of Class C stock respectively pursuant to the "interest override" requirements. During the same years, it received 143, 474, 516, 605, 523, and 630 shares of Class C stock as "patronage refunds." In its tax returns for these periods, Coastal Chemical treated the shares purchased and those received as "patronage dividends" in the same manner as Mississippi Chemical.

The Commissioner disallowed the interest deduction claimed by each taxpayer and asserted deficiencies. Taxpayers paid the deficiencies and filed claims for refund which were disallowed. Taxpayers then instituted their actions which were consolidated for trial in the district court. The court below upheld the taxpayer's contention that \$99 of each \$100 expended for the purchase of a share of Class C stock was deductible as an interest expense. In the district court the government also contended that taxpayers should have reported the Class C stock received as patronage refunds as income. The court did not sustain this position and it has been abandoned by the govern-

ment.⁶ As a result the present appeal is concerned solely with the tax treatment of the Class C stock purchased under the "interest override" requirements of 12 U.S.C. § 1134(d)(3).⁷

⁶ In a footnote to its brief the government states:

"The Government also contended in the lower court, that the taxpayers should have reported the patronage dividends (refunds) of shares of Class C stock during the taxable periods in issue as income. The lower court refused to sustain that contention. The Government has not appealed from that part of the judgment."

In this connection the following argument is advanced by amicus curiae:

"By failing to appeal from the decision below that Class 'C' stock received as patronage refunds must be included in plaintiffs' income only to the extent of \$1 per share, the government in effect concedes that the fair market value of such stock is no more than \$1 per share. Clearly the same standard must apply in assessing the value of the identical stock which is purchased pursuant to the requirements of a loan agreement."

See *Commissioner v. B. A. Carpenter*, 219 F. 2d 635 (5th Cir. 1955); *Long Poultry Farms v. Commissioner*, 249 F. 2d 726 (4th Cir. 1957); Treas. Reg. § 1.61-5(b)(1)(iv) 1959).

⁷ The same question has been involved in two recent cases. In *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372 (Ct.Cl. 1969), the Court of Claims held that amounts paid for Class C shares of the Springfield Bank for Cooperatives under the "interest override" requirements were currently deductible as interest. In *M.F.A. Central Cooperative v. Brookwalter*, 286 F. Supp. 956 (E.D. Mo. 1968), the district court allowed current deduction of the cost of Class C shares in the St. Louis Bank for Cooperatives, but considered it an ordinary and necessary business expense rather than interest. On appeal the Eighth Circuit reversed the district court and held that the cost of Class C shares was not currently deductible. *M.F.A. Central Cooperative v. Brookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

Central to the district court's decision was its finding that the Class C stock,⁸ while not worthless, was without any appreciable market value and had at most a nominal value. This conclusion is attributable to the peculiar nature of these shares. Taxpayers could only sell or transfer Class C stock to another qualified farmers' cooperative with the authorization of the Bank's Board of Directors and the approval of the Farm Credit Administration. No share of the Bank's Class C stock has ever been sold 'by a cooperative,' so there is obviously no market in this stock that would aid evaluation.

Additional characteristics of the stock severely limit its value in the hands of the taxpayers. It pays no dividend and has no growth potential. After the purchase of their initial, qualifying shares, taxpayers gained no voting rights by the purchase of additional Class C stock. The Bank has a first lien on all Class C shares.¹⁰ While the governing legislation provides that Class C shares may be retired at some date in the future, retirement will be at par (\$100) and must await the prior retirement of all Class A stock and all senior Class B shares. Retirement is also subject to the discretion of officials of the bank sys-

⁸ The New Orleans Bank does not issue certificates for the Class C shares. Thus, Class C shares are really only credits entered on the books of the bank in units of \$100 and fractional parts thereof.

⁹ The Bank's Class C shares have changed hands only at the liquidation of a cooperative or its merger with another.

¹⁰ 12 U.S.C. § 1134(d)(c).

tem. Until this uncertain retirement date,¹¹ the shares have no value to taxpayers in the usual sense. The Bank will not accept Class C shares in satisfaction of future "interest override" obligations, nor will it accept Class C shares as collateral for a loan. These factors, the limited marketability and limited value of the shares themselves, make application of the normal "willing buyer and willing seller" standard, for determining fair market value,¹² unfeasible.

The government appears to concede that these shares have no market value,¹³ but urges that they possess an "intrinsic" or "intangible" value in taxpayers' hands which renders their cost a capital investment. First, it contends that taxpayers benefit from low cost loans and other Bank services

¹¹ For purpose of valuation, the *Penn Yan* court accepted 30 or 31 years as the period required before the stock would be retired based on the history of the Springfield Bank. It is not clear to what extent this figure reflected the discretion of the bank officials or other factors which could operate to defeat or prolong recovery.

¹² [Fair market value] is the price at which property will change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts.

Willow Terrace Dev. Co. v. Commissioner, 345 F. 2d 933, 936 (5th Cir. 1965).

¹³ The Government states in its brief:

"In truth, because of the special characteristics of the stock there is no reasonable and determinable market value which can be assigned to it. As one authority puts it [Packel, *Law of Cooperatives* (3d ed.), Sec. 45(d) at 234.]: The circumstances surrounding the issuance of revolving fund certificates are often such that no particular market value can be ascribed to the certificate even though it refers to a sum certain."

because of the existence of the banking system assured through their continued purchases of Class C stock. As has been noted, however, the right to Bank services is established by the purchase of the initial qualifying shares. The government also points to the history of the Banks for Cooperatives¹⁴ which evidences a Congressional intention ultimately to withdraw all government investment from the system. This is to be accomplished by the retirement of Class A stock as the federal investment it represents is replaced by Class C investment through purchases by cooperatives and receipt by them of "patronage refunds." The government urges that when all Class A stock has been retired, the revolving fund method of capitalization, common to cooperative financing, will prevail and the participating cooperatives will be the sole owners of a valuable financial institution. It should be noted that ownership here is not synonymous with control:

Prior to 1964, the holders of Class C stock of each [regional] bank could elect only one of its seven directors, and since 1964, they have elected two of the seven. The other five directors are elected by the local district Production Credit Associations (two members), and the local district Federal Land Bank Associations (two members), with the seventh being appointed by the Governor of the Farm Credit Administration.¹⁵

With their share of control in the Bank thus limited, the fact that Class C shareholders were having capital they supplied substituted for that previ-

¹⁴ The history, organization, and capital structure of the Banks for Cooperatives is discussed by the court in *Penn Yan*, 417 F. 2d at 1373-1376.

¹⁵ *Penn Yan Aquway Cooperative, Inc. v. United States*, 417 F. 2d 1372, 1375 (Ct. Cl. 1969).

ously furnished by the government can scarcely be seen as enhancing the value of their shares. In *Penn Yan Agway Cooperative, Inc. v. United States*,¹⁶ the Court of Claims rejected the same government argument—that the Class C shares possessed intangible value. The court stated:★

[T]he cold fact remains that when plaintiff cooperative shareholder paid the \$407 for the 4.7 shares, it received stock which was greatly less valuable from an economic and financial standpoint than the purchase price required by law and the terms of the loan agreements. The “intangible benefits” bestowed by Congress on farmers’ cooperatives generally do not alter this fact . . . The required purchase of such stock gave plaintiff no economic or financial benefit other than the circumstance that it could not have obtained the loan with its favorable interest rate without fulfillment of the statutory requirement. But in the extremely practical field of taxation, in which substance prevails over form, it cannot reasonably be concluded under the circumstances that Congress has granted favors to cooperatives in furtherance of agricultural policies and taken them away (on the theory of intangible benefits) in whole or part in the field of raising of public revenues. It is obvious under the facts of this case that plaintiff did not consider, nor could it reasonably be held to have considered, that its required payment of \$407 for such stock, was an investment, as no return on such purported investment could be realized, except repayment of the bare purchase price delayed for many years.¹⁷

In *Penn Yan*, the cooperative shareholder assigned a value of \$6.90 to its Class C shares and introduced

¹⁶ 417 F. 2d 1372 (Ct. Cl. 1959).

¹⁷ *Id.* at 1377–1378.

expert testimony tending to support this general figure as a reasonable estimate of the shares' fair market value. The Court of Claims approved the cooperative's evaluation. In *M.F.A. Central Cooperative v. Bookwalter*,¹⁸ the district court concluded that Class C shares in the St. Louis Bank for Cooperatives had no fair market value at all. This conclusion was reversed by the Eighth Circuit which stated, "While the Class C stock has no established market value, it has a substantial book value and while it is likely not worth its par value at the time it is issued, it certainly has substantial value."¹⁹ It should be noted that there is a considerable difference, as to the factors affecting value, between the shares of the St. Louis bank and those involved here.²⁰ In the present case, considering the nature of the Class C stock and the testimony as to its value adduced in the district court, that court was not clearly erroneous in determining that the Class C shares had no fair market value and no more than a nominal value to the taxpayers.²¹

II

Notwithstanding the absence of a fair market value for the Class C shares, the government contends that

¹⁸ 286 F. Supp. 956 (E.D. Mo. 1968).

¹⁹ *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

²⁰ From statements contained in briefs filed in this court, it appears that by June 30, 1967 the St. Louis Bank had completely retired its Class A shares and substantially reduced the amount of Class B investment. As a consequence it was able to redeem all Class C shares issued during the fiscal year ending June 30, 1956. The M.F.A. Cooperative had purchased St. Louis Class C shares from other cooperatives, and it appears that transactions between cooperatives were not uncommon.

²¹ Rule 52(a) Fed. R. Civ. Pro.

taxpayers were not entitled to deduct any portion of their purchase price. It cites *Montana Power Co. v. United States*,²² contending:

If one buys something and pays more than it is worth, and more than he can resell it for, there are no immediate tax consequences of this everyday occurrence. . . . He must "realize" his bad bargain, his loss, by selling.

We do not dispute the soundness of this tax principle, but consider it inapplicable to the present case.²³ The government advanced the same argument in the *Penn Yan* case. The Court of Claims rejected it stating:

[I]t would be unfair to apply such a doctrine in the circumstances where disposition by the plaintiff of the class C stock was a practical impossibility due to lack of a market, which resulted from the statutory restrictions placed upon such stock under the capitalization formula prescribed by law for the banks for co-operatives.²⁴

Montana Power and the other cases relied on by the government are readily distinguished from the present situation. Taxpayers in the instant case have not been the victims of a bad bargain in the traditional sense;²⁵ they were required to make continued purchases of Class C stock in order to secure loans from the Bank. Neither did taxpayers acquire an asset of continuing value, though less than the pur-

²² 159 F. Supp. 593, 595 (Ct. Cl.), cert. denied, 358 U.S. 842 (1963).

²³ See *Ancel Green & Co.*, 38 T.C. 125 (1962); *McMillian Mortgage Co.*, 36 T.C. 924 (1961). These cases are thoroughly discussed in *Penn Yan*, 417 F. 2d at 1380-1381.

²⁴ 417 F. 2d at 1379.

²⁵ See *Montana Power Co. v. United States*, 159 F. Supp. 593 (Ct. Cl. 1958).

chase price;²⁶ the Class C shares were of no appreciable value to the taxpayers. It is at odds with the incisive realism required in determining the tax consequences of ambiguous transactions to treat these purchases as "investments"; they were something else.²⁷

We agree with the trial court and with the Court of Claims in *Penn Yan*, that the purchase price of the Class C stock (in excess of the nominal value assigned it by taxpayers) is deductible as interest in the year of purchase. Section 163(a) of the Code²⁸ provides, "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The interest which is deductible under this section is defined as, "the amount one has contracted to pay for the use of borrowed money."²⁹ As we have noted the Class C stock was without practical value to the taxpayers. Their only reason for acquiring the shares was as a prerequisite for continued borrowing from the Bank. It was in effect a bonus or premium paid in addition to the usual interest, and comes within the meaning of interest

²⁶ See *Dresser v. United States*, 55 F. 2d 499, 512 (Ct. Cl.), cert. denied 287 U.S. 635 (1932); *Koppers Co. v. United States*, 278 F. 2d 946, 949 (Ct. Cl. 1960).

²⁷ Our decision on this point appears to be at odds with that of the Eighth Circuit in *M.F.A. Central Cooperative v. Bookwalter*, — F. 2d — (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970]. Insofar as that court's decision is not attributable to the difference in value of the St. Louis shares, we are simply unable to agree. If we concluded, as did the Eighth Circuit, that the "interest override" payments were made to acquire Class C shares as capital assets, we would agree that recognition of gain or loss must ordinarily await realization through sale or exchange. However, we agree with the court below that, for tax purposes, the bulk of these payments were not actually made to acquire an asset.

²⁸ 26 U.S.C. § 163(a).

²⁹ *Old Colony R.R. v. Commissioner*, 284 U.S. 552, 560 (1932).

under 163(a) ³⁰ The *Penn Yan* court supported its similar decision with the proposition borrowed from usury cases that:

[I]f as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest. . . . ³¹

In M.F.A., the district court held that the amounts paid by the plaintiff cooperative for Class C shares of the St. Louis Bank for Cooperatives were not deductible as interest under § 163(a), ³² but allowed a current deduction as an ordinary and necessary business expense under § 162(a). ³³ The district court distinguished the cases allowing interest deductions for amounts paid as a bonus or premium to induce a loan, ³⁴ since the debtors in those cases received nothing in return for the bonus but the use of the loaned money while the M.F.A. Cooperative had received Class C stock. Because, of the peculiar nature

³⁰ *Wiggin Terminals, Inc. v. United States*, 36 F.2d 893 (1st Cir. 1929); *L-R Heat Treating Co.*, 28 T.C. 894 (1957); *Court Holding Co.*, 2 T.C. 531, 536 (1943), *rev'd on other grounds*, 143 F.2d 823 (5th Cir. 1944), *court of appeals rev'd and tax court aff'd on other grounds*, 324 U.S. 331 (1945). These cases are offered for the same proposition by the Court of Claims in *Penn. Yan*, 417 F.2d at 1379.

³¹ 417 F. 2d at 1379; quoting, *Memorial Gardens, v. Everett Vinson & Assoc.*, 264 F. 2d 282, 285 (10th Cir. 1959).

³² While the Eighth Circuit reversed the district court insofar as it allowed a deduction as a business expense, it adopted the district court's opinion on the question of interest. *M.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

³³ 26 U.S.C. § 162(a).

³⁴ See note 30 *supra*.

of the Class C shares, we find this distinction unacceptable. As the district court itself observed:

"This Classic C stock purchased quarterly was of absolutely no use or benefit to M.F.A. Central Cooperative. . . . The only reason it was purchased was because M.F.A. Central wanted to borrow money from the St. Louis Bank for Cooperatives and the agreement to purchase Class C stock was imposed as a condition of the loan. It is impossible to separate the loan from the purchase of the stock. One was the motivation for the other."³⁵

The district court in *M.F.A.* also considered the loan agreement as significant evidence that the parties understood the obligations to purchase the Class C stock to be apart from the interest requirements. We do not feel that the attitude of the parties is controlling. We agree with the Court of Claims in *Penn Yan* that a current deduction was proper and that the appropriate deduction lies under § 163(a).³⁶ As that court noted this is more logical than the § 162(a) treatment initially given the expenses by the district court in *M.F.A.*, "particularly because the amount of such stock required to be purchased by law and by the loan agreements involved was measured by a percentage of the interest payable on plaintiff's outstanding loan obligations to the bank issuing the stock."³⁷

Accordingly, the judgment of the district court is **AFFIRMED.**

³⁵ 286 F. Supp. at 961.

³⁶ The quid pro quo for taxpayer's present deduction for an interest expense will arise when and if the Class C shares are redeemed. In that event taxpayers must take \$99 into ordinary income. J. Chommie, *Federal Income Tax* § 17 at 33 (1968); 1 J. Mertens, *Federal Income Tax* § 7.34 et seq. (1969).

³⁷ 417 F.2d at 1382.

GODBOLD, Circuit Judge, dissenting:

The majority opinion is a demonstration of what one of the few authorities on the law of cooperatives has counselled against:

The entire field of cooperative corporation law is so relatively new, the basic principles of the cooperative plan are so fundamentally different from those of corporations for profit, and the temporary or interim character of the capital required for proper functioning of a cooperative is so different from the permanent share capital of other business corporations, that even well established concepts in the field of business corporation law cannot safely be applied to cooperative corporations without careful understanding of the reasons underlying those principles and the applicability or inapplicability of those reasons to cooperatives. The fable of the three blind men's impressions of an elephant holds a pointed moral for judges and lawyers approaching the problems of cooperative corporation law and, particularly, the problems of financial structure and operation of cooperatives. Revolving capital cannot be assumed to result from the creation of either an exclusively debtor-creditor relationship or an exclusively corporation-shareholder relationship. Rather it involves a blending of certain elements of both, and frequently something new has been added as well. The resultant product is *sui generis*. In the long run, the public interest will best be served by thorough, patient, and understanding comprehension of what participants in a cooperative enterprise are trying to achieve, rather than by unwarranted assumption that new legal relationships arising from cooperative business transactions and organizations must be neatly and quickly, albeit somewhat forcibly, classified according to preexisting legal concepts developed under different conditions for

different purposes in different kinds of transactions and organizations.

Nieman, *Revolving Capital in Stock Cooperative Corporations*, 13 *Law and Contemporary Problems* 393 at 402 (1948).

The taxpayers are incorporated farmers' cooperatives. In issue is the tax treatment of amounts which they have paid for Class C stock which they hold of the New Orleans Bank for Cooperatives, an incorporated stock cooperative of which they are members and from whom they borrow.¹ The taxpayers say, on the one hand that the amounts were not paid for a capital asset, which under 26 U.S.C. (1964 ed.) § 1221 is "property held by the taxpayer" (with designated exceptions none of which is contended to be applicable). They say that in truth all or substantially all of the amounts paid, though cast in the form of the purchase price of capital stock, really were amounts which they had contracted to pay for the use of borrowed money and therefore were interest.² As probative of both of these contentions their underlying argument is that the Class C stock lacks many of the usual characteristics of stock and that it has only nominal value. The government contends the stock is a capital asset, and, recognizing that it may not have fair market value in the usual sense of a willing buyer and a willing seller, says it has intrinsic value.

¹ The purchases were made by Coastal between 1958 and 1963 in the total amount of \$211,799.68, and by Mississippi Chemical between 1961 and 1963 in the total amount of \$55,113.19. Tax refunds ordered by the District Court are \$265,044.35 to Coastal and \$85,298.51 to Mississippi Chemical.

² E.g. *Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 76 L.Ed. 484 (1932).

Once one grasps the function of this particular stock in an institution organized by the Congress as a cooperative³ it is seen that the stock is a capital asset, "property held by the taxpayer," although it does not have the usual characteristics of stock in a commercial enterprise organized under general corporation laws. Once that is seen—if not before—the contention that the payments for Class C stock are interest falls.

The Eighth Circuit, in *M.F.A. Central Cooperative v. Bookwalter*, F. 2d [8th Cir., No. 19,527-531, June 8, 1970], has reached the same conclusion which I reach. That court held that the required quarterly investments in Class C stock were payments for capital assets. It affirmed the holding of the District Court⁴ that the payments were not interest, and reversed the holding that they were ordinary and necessary business expenses. In so doing it considered *Penn Yan Agway Cooperative v. United States*, 417 F. 2d 1372 (Ct. Cl. 1969) and the District Court opinion in the present case and would not follow them.⁵

1.

Central to this case is the fact that the New Orleans Bank for Cooperatives is itself a cooperative. "A cooperative is an association which furnishes an economic service without entrepreneur profit and which is owned and controlled on a substantially equal basis by those for whom the association is rendering service. . . . '[E]ntrepreneur profit' . . . really represents

³ Under a charter issued by the Farm Credit Administration.

⁴ *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo. 1968).

⁵ *Penn Yan* held that the purchase price of Class C stock was interest to the extent that it exceeded \$6.60 per share, which the taxpayer conceded was its value.

the antithesis of the benefits normally ascribable to cooperatives. 'Entrepreneur profit' is used in the true economic sense of a return for the speculative or risk element in an enterprise. In a cooperative, all the members assume, in a broad sense, the economic risk, and they contemplate no return for the undertaking of the risk." Packel, *The Law of Cooperatives*, § 1, p. 2-3 (3d ed.).

"The primary objective of an ordinary cooperative is not charitable. . . . In the normal case . . . the cooperative is designed to further the economic interest or welfare of its members. Economic welfare does not merely refer to financial savings or increased monetary returns. It cuts much deeper and takes into consideration basic aspects of economic life. Quality of product, decency of service, ownership, control and satisfaction of self-help are important benefits of cooperatives and sometimes are even more important than the direct financial benefits." *Id.* at pp. 6-7. Among the normal attributes of a cooperative are:

* * * * *

(3) transfer of ownership interests is prohibited or limited;

(4) capital investment receives either no return or a limited return;

(5) economic benefits pass to the members on a substantially equal basis or, on the basis of their patronage of the association;

Id. at 3.

Justice Brandeis pointed out in his dissent in *Frost v. Corporation Commission*, 278 U.S. 515, 536, 73 L.Ed. 483, 495 (1929) that farm cooperatives seek, in addition to the immediate and direct financial advantage of members, a type of economic democracy as well in which there is equitable assumption of re-

sponsibilities and equitable distribution of benefits and that in addition to financial benefits they promote and effect cooperation among farmers. These objectives, coupled with that of economic strength springing from the combination in a single institution of the combined effort and contributions of all, is important in grasping the relationship between the appellant cooperatives and the cooperative financial institution from which they borrow.

2.

As Professor Nieman points out, the capital of a cooperative, insofar as permanence or impermanence of shares of stock or other units of capital is concerned, is essentially different from the capital of other business corporations.⁶ The commercial shareholder does not anticipate his contribution to capital will be returned to him until dissolution. Prior to dissolution he can recover his contribution by selling his shares to another.

A cooperative's capital, however, more often represents essentially a loan or temporary contribution by its patrons to finance certain economic services for them. The patron-member or patron-shareholder expects that the capital which he contributes will be returned to him prior to dissolution, but not until his own and other patrons' subsequent contributions to capital render his earlier contribution unnecessary to finance the cooperative's facilities and operations. He does not expect to wait until dissolution, and he knows that his shares are not readily salable. He looks to the cooperative to return his capital contributions to him if, and as soon as, it can do so.

⁶ Nieman, *supra*, at 393.

Nieman, supra, at 393-94. This concept is a formalization of early, informal cooperative arrangements.⁷ As cooperatives became more permanent and more continuous in their operations the patron who temporarily put his capital at the service of the group, footnote 7, *supra*, no longer took it home with him when his transaction was over but left it for the use of the continuing activity, though not for its permanent use. But the bedrock principle remained that he received no return or a limited return on his investment in capital.

Most of the formalized early cooperatives were corporations, which organized and structured their capital under the general corporation laws, the only laws available, though unrelated to the particular capital requirements of the cooperative. *Id.* at 393 and 395. "There ever since has been a trial-and-error effort to develop for cooperatives a kind of capital more adequately suited to their peculiar needs and still within the corporate form." *Id.* at 395.⁸

⁷ "When more than a century ago, a group of Ohio farmers joined together to ship their cattle to market at Pittsburgh, each of them presumably furnished his share of the cattle, wagons, and equipment which were the capital for the expedition; and each participant's capital was returned to him upon the completion of the project. The horses, wagons, machinery, and labor required for barn raisings or threshing were furnished by the participants, and were returned to them after each job or threshing season. Each participant ceased to provide such capital, and capital previously furnished was returned to him, when he ceased farming and, thus, no longer had need for the barn-raising or threshing services and equipment of his neighbors. In such informal, cooperative enterprises, the temporary nature of the capital employed was plain." *Id.* at 394.

⁸ Today, in most jurisdictions, a cooperative can incorporate either with or without capital stock. Packel, *supra*, § 5(c) at p. 35.

As cooperatives evolved, necessity imposed the creation of a new kind or temporary or interim capital, revolving fund capital.

Provision frequently was made for the return of a member's share of the capital upon the termination of his membership. The risk to the cooperative's financial integrity in the event that a substantial number of members should withdraw and demand the return of their membership capital at the same time required modification of the right to demand a return of membership capital promptly upon termination of membership. Provision was made to suspend the rights and privileges of membership or to retain the member's share of the capital until such time as the cooperative should be financially able to pay it out without undue prejudice to other members or creditors. The problems incident to the existence of permanent capital, even membership capital repayable upon termination or suspension of membership or reasonably soon thereafter, eventually were met by the creation of a new kind of temporary or interim capital which has now become quite common, although peculiar to cooperatives—that is, revolving-fund capital.

Id. "The revolving fund plan 'has been likened to a water wheel, picking up water, using it to create the power that turns the mill machinery, and returning the water to the millstream.' " *Id.* at 396. As the fund of capital becomes adequate it is maintained at that level by continuing to receive each year new contributions to capital by current patrons, and to the extent that new contributions increase the capital above that needed the excess is returned to the patrons who made the earliest contributions. Necessarily there is some awkwardness in the use of shares of stock in a cooperative with revolving capital, but these are tempered by employing different classes of shares. *Id.* at 398-402.

The relationship of the stock cooperative to the member-stockholder who contributes capital is not strictly debtor-creditor, for there is no loan with a maturity date, nor corporation-shareholder in the commercial sense. Though styled corporation-shareholder it is in fact *sui generis*. Nieman, *supra*, at 397 and 402.

3.

It is against this background of recognized principles of cooperative organization and operation that Congress has established a comprehensive farm credit system, which is but a part of a broader program of encouraging the organization and development of effective cooperatives.⁹ The cornerstone was the Federal Farm Loan Act of 1916,¹⁰ establishing the federal land banks with goals of providing low cost farm credit, promoting farmer ownership of the banks, and established and stimulating among farmers cooperative effort.¹¹ Farmers could not borrow directly but were required to form national farm loan associations, which, operating on cooperative principles, would serve as middlemen in securing loans. These cooperative associations were required to purchase stock in the federal land banks in amounts relating to the size of loans (5 per cent of face.)¹²

The Farm Credit Act of 1933¹³ established a much broader structure of farm credit around the original

⁹ Packel, *supra*, § 60, p. 275 et seq.

¹⁰ 39 Stat. 360.

¹¹ S. Rep. No. 144, 64th Cong.; 1st Sess. pp. 2, 4 and 10.

¹² The Senate Report said of this requirement:

"At the outset we secure the personal interest of the borrower by requiring him to contribute to the capital of the loan association 5 per cent of the face of his loan. This personal stake makes the . . . borrower a cooperator."

S. Rep. No. 144, *supra*, p. 10.

¹³ 48 Stat. 257.

twelve federal land banks. Among the new institutions were the Central Bank for Cooperatives and twelve regional banks for cooperatives which had the specific function of lending to farmers' cooperatives. The initial capital, comparatively nominal, was furnished by the United States in the form of \$110 million, divided between the twelve regional banks and the Central Bank.¹⁴ Each regional bank had but one class of stock. Each borrowing cooperative had to become a member of the regional cooperative bank and a contributor to its capital by purchasing stock (or subscribing to a guaranty fund) in an amount related to the size of his loan. The purchase price of the stock was paid when the loan was closed, either by being deducted from the proceeds or added to the amount of the loan. However, upon repaying his loan a borrower could withdraw his contribution to capital by demanding redemption of his stock. These withdrawals caused the capital funds remaining in the banks to be insufficient to permit them to operate on a sound basis and to meet the needs of the farmer cooperatives for credit.¹⁵

This is the difficulty which, as Professor Nieman points out, gives rise to revolving fund capital. In 1955 Congress changed the capital structure of the 12 regional banks and the Central Bank for Cooperatives to the revolving fund system.

The Farm Credit Act of 1953 required a study of methods by which to effect increased borrower participation in the management, control, and ultimate ownership of institutions operating under the permanent system of agricultural credit available through the Farm Credit Administration. 2 U.S. Code & Admin. News 1955 at 2947, 2949. The Farm Credit

¹⁴ 2 U.S. Code & Admin. News 1955, p. 2949, at 2950.

¹⁵ 2 U.S. Code & Admin. News 1955 at 2951; *Penn Yan. supra*, at 1374.

Act of 1955, 69 Stat. 655, which overhauled the entire system of farm credit, was the result of that study. The Senate Committee reported that the House Bill (in no relevant aspect different from the Senate Bill or the Act as passed) "would be a forward step in the goal of having private borrowers owning and managing these credit agencies." *Id.* at 2948.

The House Committee Report described the purpose of the legislation in this way:

The primary purpose of title I of the bill is to provide a plan under which the banks [for cooperatives] would be organized on a truly cooperative basis. Borrowing cooperatives would continually make capital contributions to the system so long as they used its credit service. Each year final net savings (after taxes, dividends, reserves, and surplus requirements) would be distributed as patronage refunds to borrowing cooperatives in the form of capital stock, all of which capital would remain in the system until all of the capital stock of the United States had been retired. Each year Government capital would be retired in an amount equal to the required stock contributions of and the patronage refunds to the borrowing cooperatives.

Id. at 2951.

The Act established a pure revolving fund capital structure. *Penn. Nat. Bank v. Federal Reserve Bank*, 417 F. 2d at 1374. It created Classes A, B and C stock, A owned by the government (nonvoting and no dividends); B owned by investors (nonvoting but dividend paying), and C (voting but only one vote to a member, no dividends). 12 U.S.C. § 1134d. Each year, as capital is added through investment in Class C shares by each borrower, and through distribution to borrowers of patronage refunds in the form of Class C shares, an equal amount of Class A shares is retired. Retirement

of Class C shares will commence when all Class A stock has been retired, except that as Class C is retired all earlier issued Class B must also be called for retirement.¹⁶ There is no retirement of stock on demand.

In lieu of the one-time purchase of stock previously required of each borrower, the 1955 Act substitutes a system of scheduled purchases of Class C stock. "[E]ach borrower . . . shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum . . . of the amount of interest payable by it to the bank during the calendar quarter. Payment for such stock shall be made quarterly or when the regular interest payments of the borrower are payable." 12 U.S.C. § 1134 d(a) (3). Prior to the 1955 Act required purchases were unrelated to interest but keyed to the amount of the loan. Post-1955 purchases are keyed to interest only as a measure of the amount of stock to be purchased. It is obvious that they are keyed to payments of interest for convenience of billing and payment—the borrower pays his scheduled contribution to capital when he makes his interest payment, whether quarterly or otherwise. Amounts due for interest and investment in stock are rendered in the same bill, although separately stated and identified. A borrower who owns Class B stock and does not want to make the required investment in Class C stock by paying cash can convert his Class B to Class C. 12 U.S.C. § 1134 d(a) (3). This has been done by the New Orleans Bank in many instances,

¹⁶ The Class B shares are of nominal importance. In 1963 they constituted only approximately 5 per cent of total stock outstanding in the New Orleans Bank.

always on a dollar-for-dollar basis, \$100 par value of Class C for \$100 par value of Class B.^{16A}

Pre-1955 stock can be converted to Class B or Class C. This has been done on the same basis of dollar for dollar of par value. Some holders of pre-1955 stock have been allowed to apply the full par value thereof against their loans outstanding.

The bank has a statutory lien on the borrower's Class C stock. In cases where it has been exercised against a defaulting borrower, the full par value of the stock has been applied to the loan balance.

In 1956, promptly after the 1955 Act went into effect, the New Orleans Bank established 15 per cent of interest payable during the quarter as the amount of quarterly investment in stock required of the borrower. It did so pursuant to a policy determination that it hoped to retire all Class A stock by 1976, a 20-year period, and projected the 15 per cent figure as sufficient to achieve that. Retirement has been carried out each year as planned except that the rate of retirement has been better than expected. By 1963 Class A stock had been reduced from the 1956 level of \$7,000,000 to \$4,880,000, as against the projected level for that year of \$5,150,000. In 1966 the Bank estimated informally that all Class A stock would be retired by 1972 or 1973.¹⁷

^{16A} The necessity of not being hypnotized by the phraseology of the commercial corporation is pointed up by 12 U.S.C. § 1134 d(b). If a borrower is not authorized under the law of the state of its organization to take stock in the bank, it must deposit in the "guaranty fund" of the bank the amount it would have invested in stock. This is the contribution to capital by the cooperative patron in its pure sense, unencumbered by share of stock conceptualism. Patronage refunds to such a borrower are credited against its contributions to the fund. Its deposit is returned to it in the same manner as Class C stock is redeemed.

¹⁷ The supplemental brief of the United States quotes from an exhibit in the M.F.A. record which states that five of the

Purchase of a single Class C share is a prerequisite to eligibility to borrow from the bank. 12 U.S.C. § 1134 d(a)(3). The District Court, the majority in this case and the court in *Penn Yan* viewed the purchase of this single share as conferring upon the purchaser the full spectrum of benefits that could flow to it from stock ownership, so that no additional benefit could accrue by its securing a loan and, as an incident thereof, purchasing additional stock as required. This misses the whole point of the cooperative structure of the banks. The thrust of the Congressional scheme is the promotion of permanent institutions to supply low cost credit to farmers' cooperatives and to foster the creation of additional cooperatives.¹⁸ Ownership of the bank ultimately will be in the cooperatives. They will also participate in management, to the extent of the private sector of the joint government-private management scheme. A purchase of Class C stock does not increase the capital of the bank or its current lending capacity, since Class A stock in a like amount is retired. But each purchase moves the bank toward its ultimate institutional status as a farmer-owned cooperative supplying low cost farm credit to these taxpayers and others like them. The government "primed the pump" by "revolving in" the initial capital of a joint government-private

regional banks have retired all Class A stock and that it is anticipated that all others will accomplish full retirement of the government's investment by 1971.

¹⁸ The 1963 report of the New Orleans Bank states that more than half of the cooperatives regularly financed by it are the outgrowth of conferences held by its staff with groups of farmers contemplating the establishment of new cooperatives.

undertaking, the societal values of which it is not the judicial function to question, and from which the government's capital was designed ultimately to be wholly "revolved out." To view the process of replacing government capital by private capital, as do taxpayers, as producing no benefit to anyone except the government which gets its money back, is to misunderstand both the purpose of Congress and the institutional value of the cooperative bank to the cooperatives which will own it and borrow from it.¹⁹

There are institutional values other than that of continued availability of low cost credit. There is the inherent cooperative concept that it is beneficial to channel into a single integrated effort the assets and needs of the group of patrons. There is the benefit of simple economic power, through ultimate substantial ownership of the established, fully capitalized, staffed, and accepted financial institution.^{19A}

¹⁹ The benefit to these taxpayers, of the New Orleans Bank as a source of low cost credit, is quickly seen by a look at the years here in question. Their purchases of Class C stock for these years were, in round figures: Coastal (1958-63)—\$11,700; \$33,900; \$47,100; \$41,700; \$35,000; and \$42,100. Mississippi (1961-63)—\$18,900; \$16,800; and \$19,300. Each purchase represents 15 percent of the interest paid for the year. Interest usually was between 4 and 5 percent. A simple calculation reveals the massive extent of the loans which they were enjoying.

From its organization through fiscal 1963 the New Orleans Bank made loans to its limited class of borrowers in its region (Louisiana, Mississippi and Alabama) of more than 618 million.

^{19A} Also it should be noted that the major source of loan funds for each bank is not its capital but funds which it obtains by borrowing from the Central Bank and the federal intermediate credit banks and by sale of debentures in cooperation with other regional banks. This access to low cost funds, and government-assisted credit, continues after Class A stock is retired.

Other benefits are perhaps more easily perceived because in the more conventional garb of dollars. As borrowers, taxpayers qualify for patronage refunds, distributed to them annually in proportion—as in all cooperatives—to their use of the services offered, thus in this instance measured by interest paid. In 1958–63 Coastal received patronage refunds in Class C stock of \$289,309.81. In 1961–63 Mississippi received \$81,272.57. Together these are 14 per cent of all Class C stock (purchases and refunds) outstanding at the end of fiscal 1963. When their purchases of Class C stock for those years are added, it is revealed that together the taxpayers owned 24 per cent of the outstanding Class C stock.

Also each bank allocates on its books each year to each patron, in proportion to interest paid by the patron, a portion of the amount by which the bank's contingency reserves exceed its needs.²⁰ For the same years as above, Coastal was allocated from surplus \$127,748.62, Mississippi \$35,771.48. This "allocated surplus" eventually is distributed in the form of Class C shares.²¹ The patronage refunds and the allocated surplus are not a return of the borrower's contributed capital but distributions of earnings, not presently convertible to cash but in due course "revolved out" of the cooperative capital into cash to the borrower.

These benefits are measured by the borrower's use of services. But he does not qualify for them by the act alone of borrowing, only by borrowing plus contributing to capital. Congress could have chosen other

²⁰ Included therein are like distributions which the regional bank receives from the Central Bank for cooperatives.

²¹ The separate increments of value represented by the Class C stock (purchased and patronage refunds) and the allocated surplus are pointed out in *Columbia Bank for Cooperatives v. Lee*, 368 F.2d 934 (4th Cir. 1966).

approaches. A large contribution to capital to become eligible for service was a possibility, but this would be inconsistent with the cooperative concept of nominal financial outlay to become a patron (a small membership fee for the nonstock cooperative, a small purchase of stock for the stock cooperative), with the real and substantial contribution to capital made in proportion to use of services. It would be inconsistent with the aim of fostering organization and growth of fledgling cooperatives. Congress could have required a large one-shot contribution when the loan is made, but it had discovered the disadvantages of this before 1955. It could have provided for adding to capital by higher interest rates carried forward into earned surplus, but this would be inconsistent with its purposes of offering low rates and at the same time shifting from government to private ownership through the normal revolutions of revolving fund capital.

5.

The *sui generis* stock of an incorporated cooperative need not have the same characteristics as ordinary commercial stock to be a capital asset. But the differences loom so large in the minds of the plaintiffs, of the District Court²² and the majority in this court, that brief comment is appropriate.

No Class C stock certificates are issued. A form for the certificates has been approved by the Farm Credit Administration, but the Board of Directors of the New Orleans Bank exercised the discretion given them by

²² The District Court, after emphasizing the differences, concluded that the stock "does not enjoy the usual attributes of shares of stock but are mere bookkeeping entries or devices." The District Court made no references to the peculiarities of cooperative financing. In fact its opinion does not even reveal that the New Orleans Bank is a cooperative.

the bylaws not to issue certificates. The Bank reflects on its stock ledger the amount of each type of Class C stock owned and at the end of each fiscal year notifies each owner of the amount owned at the beginning and end of the year.²³

The stock has no dividend and no growth potential. This is normal for a cooperative.

Only the first share of Class C stock carries a voting right. "One person one vote" is a basic cooperative principle, which gives recognition to the concept of an economic democracy. Packel, *supra*, at 138-40.²⁴

Class C shareholders will not enjoy sole control of the bank in the commercial sense even when all Class A stock is retired since they will not elect all directors of the joint board which administers it and other farm credit agencies of the region. This makes the stock different from some commercial stock²⁵ but no less a capital asset.

The stock is not transferable except to other coop-

²³ This system of recording stock ownership without issuing certificates is no surprise to any holder of shares of almost any one of the major mutual funds which employ the same method for shareholders authorizing automatic reinvestment of dividends and which, like the New Orleans Bank, notify the shareholder periodically of how many new shares he has acquired.

A certificate of stock is not the stock itself but only evidence of ownership. The rights and duties between corporation and stockholder exist apart from the certificate. 11 Fletcher, Corporations, § 5092 (Perm. ed.).

²⁴ The principle is carried forward into the Capper-Volstead Act under which a cooperative marketing association, if it wishes to enjoy immunity from the Sherman Act, must not allow a member more than one vote regardless of how much stock he owns. 7 U.S.C. §§ 291-292.

²⁵ Commercial preferred stock often is nonvoting, and nonvoting common of many companies is traded daily on the stock exchanges.

eratives and with the consent of the Bank.²⁶ This is usual in a cooperative. Packel, *supra*, pp. 3, 127. It is essential to keep out of the membership persons with interests antagonistic to the cooperative and is an effective means to keep patrons from transferring their interests at a profit, *Id.* at 127-128 and cases there cited.

6.

The majority center on, and repeatedly employ, the phrase "interest override," and even characterize the requirements of the statute in those terms. The term nowhere appears in the statute, the Congressional history, the loan agreements, or the quarterly bills sent taxpayers showing separately interest, principal and "C stock subscription." The President of the New Orleans Bank explained that the term had grown up in that regional bank and in turn had been picked up by its borrowers.

Class C stock purchased under the required investment provisions is shown in the stock ledger separate from that issued as patronage dividends, and under the heading "Investment in C Stock (Interest Override)." The President defined "interest override" as "the amount we require our borrowers to pay over and above interest for the purchase of C stock."

The promissory notes signed by taxpayers provide for interest. Each separate loan agreement provides:

Stock Purchase: The association shall invest quarterly in class C stock of the bank at its fair book value, not exceeding par, an amount equal to 15 per cent of the amount of interest

²⁶ There have been a few approved transfers incident to liquidation, merger or accommodation between cooperatives.

But compare *Columbia Bank for Cooperatives v. Lee*, 308 F.2d 934 (4th Cir. 1966), stating that once issued Class C stock is transferable to any person.

payable by the association to the bank on said loans for said calendar quarter or part thereof. The association shall pay for said class C stock on the date interest is due and payable. . . .

7.

The plainly erroneous rule applied to the finding of the District Court that the Class C stock has only nominal value, may not be the basis of an affirmance. What has been said makes clear that the stock has, as the Eighth Circuit concluded in *MFA*, an intrinsic value. Also it is apparent that the District Court's finding was based on the erroneous basis of comparing the stock, characteristic by characteristic, with that of the usual commercial corporation and totally overlooking its value as a capital contribution to a cooperative under the plan of the Congress.

On the issue of value, in *Columbia Bank for Cooperatives v. Lee*, 368 F. 2d 934 (4th Cir. 1966), a bankrupt cooperative owned Class C stock of the Columbia regional bank with a par value (in round figures) of \$54,200, Class B stock with a par value of \$45,800, and there had been allocated to the bankrupt surplus of \$13,000, total \$113,000. The referee ordered the bank to allow a setoff of this \$113,000 against the cooperative's indebtedness to it of \$162,000, and the District Court affirmed.²⁷ Another cooperative had offered to buy the stock for \$50,000, which was 45 per cent of its par value and allocated surplus. The Fourth Circuit held that the bank was not required to offset at par value and remanded for valuation by the referee. It declined to accept the single offer of \$50,000 as a reasonable reflection of true value and noted, "However thin the general market for these shares

²⁷ The New Orleans Bank in many instances has made just such a full offset without legal proceedings.

may be, the continuing stream of borrowers from the bank provides it with a ready market." 368 F. 2d at 940.²⁸ The Columbia Bank projected retirement of all Class A stock by 1967. New Orleans Bank stock may be worth less than 45 cents on the dollar because of the difference between projected 1967 retirement of Class A and projected 1972-1973 retirement. But the discount is not to \$1.00 per share or less. In the present case an expert familiar with cooperative financing presented a full and careful analysis of Class C stock of each year separately and assigned values ascending from \$3.42 per share for 1958 Class C stock to \$38.65 per share for that of 1963.

8.

My brothers have, in Professor Neiman's terms, felt the leg of the elephant and concluded that the beast is interest. A look at the concept of cooperatives, the legislative history, the expressed intent of Congress, the language of the statute, the books and records of the parties and the loan agreements signed by the taxpayers, reveals that it is an elephant after all. I would join with the Eighth Circuit and would reverse.

²⁸ On remand (not officially reported) no valuation by the referee was necessary. The parties agreed that the trustee would receive a credit in the amount of the value of bankrupt's stock plus allocated surplus, a total of \$112,694.97, and the trustee agreed to pay the bank cash of \$49,305.03, which was the balance of the bank's claim.

• APPENDIX C

United States Court of Appeals for the Fifth Circuit

October Term, 1969

No. 28271

D.C. Docket No. CA 1213 and 1214

MISSISSIPPI CHEMICAL CORPORATION,
PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

COASTAL CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeal from the United States District Court for the
Southern District of Mississippi*

Before GEWIN, GODBOLD, and CLARK, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Mississippi, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered

and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that defendant-appellant pay to plaintiff-appellee, the costs on appeal to be taxed by the Clerk of this Court.

SEPTEMBER 14, 1970.

Issued as Mandate: October 6, 1970.

A true copy:

Test:

EDWARD W. WADSWORTH,

Clerk, U.S. Court of Appeals, Fifth Circuit.

By CLAUDETTE STAIGER,

Deputy.

New Orleans, Louisiana, October 6, 1970.

APPENDIX D.

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General*.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

SEC. 163. INTEREST.

(a) *General Rule*.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term “capital asset” means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, or similar property held by—

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1); or

(5) an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue.

JAN 11 1971

E. P. ...

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

70-52

No. ~~1082~~

UNITED STATES OF AMERICA,

Petitioner,

vs.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

**RESPONSE TO PETITION FOR WRIT OF CERTIORARI
IN THE SUPREME COURT OF THE UNITED STATES**

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Chemical Corporation, Respond-
ents*

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HOLLAMAN M. RANEY, Of Counsel

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**IN THE
SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1970

No. 1082

UNITED STATES OF AMERICA,
Petitioner,

VS.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

**RESPONSE TO PETITION FOR WRIT OF CERTIORARI
IN THE SUPREME COURT OF THE UNITED STATES**

MEMORANDUM FOR THE RESPONDENTS

The Solicitor General, on behalf of the United States of America, has filed a petition for writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in the consolidated cases of Mississippi Chemical Corporation and Coastal Chemical Corporation, Plaintiffs-Appellees v. The United States of America, Defendant-Appellant. This memorandum is filed in behalf of the Mississippi Chemical Corporation and the Coastal Chemical Corporation as respondents to the petition.

RESPONSE TO STATEMENT AND REASONS FOR GRANTING THE WRIT

Three cases have been recently decided by appellate courts involving the taxation of Class C stock in banks for cooperatives formed under 12 U.S.C.A. Sec. 1141, et seq.

The first case was decided by the Court of Claims on September 14, 1969, being *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372. A copy of such decision of the Court of Claims is attached hereto as Appendix A for the convenience of this Court. The United States did not attempt to obtain a review of this decision by this Court under Section 1255 of Title 28, U.S.C., and the decision has become final. That case involved Class C stock of the Springfield Bank for Cooperatives.

The second case is that of *M.F.A. Central Cooperative, et al., v. Edwin O. Brookwalter, District Director of Internal Revenue*, 427 F. 2d 1341, decided by the United States Court of Appeals for the Eighth Circuit on June 8, 1970. Petition for writ of certiorari is now pending before this Court in Cause No. 824 at this term of this Court. That case involved Class C stock of the St. Louis Bank for Cooperatives.

The third case is the case at bar in which the decision of the Court of Appeals for the Fifth Circuit was rendered on September 14, 1970, and appears in 431 F. 2d 1320, a copy thereof being attached as Appendix B to the Petition for Writ of Certiorari herein. This case involves Class C stock of the New Orleans Bank for Cooperatives.

The basis claimed for the granting of the Petition for Writ of Certiorari is that there is a conflict between the Circuits arising from these cases. We respectfully disagree with this conclusion for the reasons hereinafter set forth.

QUESTION PRESENTED HERE

Whether, under the differing facts in these three cases there is a conflict, of sufficient importance to warrant the issuance of a writ of certiorari, between the decision of the Court of Appeals for the Eighth Circuit in *M.F.A. Central Cooperative* (on the one hand) and the decisions of the Court of Claims and the Court of Appeals for the Fifth Circuit in *Penn Yan Agway Cooperative* and *Mississippi Chemical Corporation*, respectively (on the other hand):

In each of these cases the taxpayer, as a borrower from the bank, was required by the statute and the loan documents to pay an "interest override", amounting to fifteen per cent of the interest payable upon its loans for each calendar quarter. This "interest override" was credited upon the books of the bank to an account of the taxpayer designated as "Class C Stock". The question in each case was whether the entry of this credit (sometimes referred to as the "issuance by the bank" or the "purchase by the borrower" of Class C stock) constituted receipt by the taxpayer of sufficient value to render such "entry", "purchase" or "issuance" taxable in the full amount of the entry, i.e. \$100.00 per share of Class C stock thus entered.

At the end of each year there was also credited to such "Class C Stock" account "patronage refunds". The attributes of these two types of entries were identical. On the appeals in both the Eighth Circuit and the Fifth Circuit and also in the Court of Claims, the United States did not contend that such "Class C Stock", i.e. the entries covering patronage refunds, were taxable either in the full amount thereof or in any amount.

The basic issue determined by each of the three Courts, as to which there was a reasonable difference of

opinion and as to which there was a different finding in each case, is not a question of law, but solely a question of fact—i.e. what portion of each \$100.00 paid as “interest override” was in substance and in fact (a) paid for the use of money (either as interest under IRC Section 163 or as an ordinary and necessary business expense under IRC Section 162) or (b) paid for the Class C stock entered upon the books of the bank.

It is implicit in the taxpayer's argument in each of these cases that any portion of each \$100 which could fairly be held to have been paid for the Class C stock would not be deductible when paid; such amount would constitute the tax basis of the stock which would determine the profit or loss realized when the stock was disposed of. What all of these taxpayers have contended is that they should be entitled to deduct, either as interest or as a business expense, that portion of the price *purportedly* paid for this stock which was *in fact* paid, not for such stock, but rather solely for the use of money.

Penn Yan Agway Cooperative

~~In~~ *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372, the Court of Claims found that the 15% paid constituted a “surcharge on interest” (p. 1375); “the plaintiff did not receive any special services other than the lending of money from the Springfield Bank” (p. 1376); that shares of Class C stock “gave plaintiff no additional voting rights, no additional right to share in the profits of the bank, and no additional benefits of any kind” (p. 1376); that “the only right they carry and have carried is long-delayed redemption at their bare purchase price” (p. 1378); that “there have been no sales of Class C stock other than issuance by a bank for cooperatives to a borrowing farmers’ cooperative.” Plaintiff reason-

ably believed that there was no market for such stock". (p. 1377.) The Court further held:

Plaintiff reasonably believed that there was no market for such stock. The fair market value of plaintiff's 407 shares of class C stock was established at \$6.90 per share as of the time of its acquisition by plaintiff in 1959 by expert stock evaluation testimony adduced by plaintiff.

Without burdening this Response unduly, we point out that the Court held that the difference between value of \$6.90 per share and the entry of \$100 per share was "interest paid and deductible under Section 163 of the Internal Revenue Code", saying (p. 1378):

Of course, Congress considered the 15 percent surcharge on interest payable on loans as a means of providing capital to the banks for cooperatives, and the bank realistically and lawfully treated as capital, funds received in that manner. But from the standpoint of plaintiff-taxpayer, this was in reality an increase of the basic interest rate as an experienced cost of borrowing money from the bank, even described in the statute and in the loan agreements as a percentage of interest payable on the loans. Its expenditure of \$407, at least in greater part, was in reality an item of cost of conducting its business, and in the absence of compelling law to the contrary, and to the extent that it was a reasonably ascertainable cost, should be offset against plaintiff's income in the taxable year involved, in accordance with the annual accounting principle of the federal income tax laws. This is true whether such ascertainable cost is deemed interest paid under § 163 or an ordinary and necessary business expense under § 162 of the Internal Revenue Code of 1954.

M.F.A. Central Cooperative

In *M.F.A. Central Cooperative v. Brookwalter*, the district court concluded that Class C shares in the St. Louis

Bank for Cooperatives had no fair market value at all. This conclusion was reversed by the Eighth Circuit. Although different results were reached in *M.F.A. Central Cooperative* and in the case at bar, a conflict between the Circuits has not arisen because of the wide variation in the evidence in the two cases. The material differences were found by the Court of Appeals for the Fifth Circuit as follows:

In *M.F.A. Central Cooperative v. Brookwalter*, the district court concluded that Class C shares in the St. Louis Bank for Cooperatives had no fair market value at all. This conclusion was reversed by the Eighth Circuit which stated, "While the Class C stock has no established market value, it has a substantial book value and while it is likely not worth its par value at the time it is issued, it certainly has substantial value". It should be noted that *there is a considerable difference, as to the factors affecting value, between the shares of the St. Louis bank and those involved here.* Note 20.

Note 20. From statements contained in briefs filed in this court, it appears that by June 30, 1967 the St. Louis Bank had completely retired its Class A shares and substantially reduced the amount of Class B investment. As a consequence it was able to redeem all Class C shares issued during the fiscal year ending June 30, 1956. The M.F.A. Cooperative had purchased St. Louis Class C shares from other cooperatives, and it appears that transactions between cooperatives were not uncommon.

For convenience of the Court we quote the summary of the evidence in *M.F.A. Central Cooperative* contained in the brief filed by the United States in the District Court:

Furthermore, plaintiff, as an owner of Class C stock, not only possesses the right to receive par value upon its retirement, but may *freely transfer it to other cooperatives.* Specifically, *plaintiff on three separate*

occasions purchased Class C stock from other farm cooperatives and, indeed, requested the Bank to record the transfer. (Tr. 227; Ex. I.) When this purchased stock was retired, plaintiff received its full par value. (Tr. 230; Ex. J.) Moreover, the freedom to transfer Class C stock is clearly demonstrated by the fact that such shares issued by the Bank during 1956 were transferred between farmers' cooperatives on 48 separate occasions. (Tr. 271.) There is no reason to assume that similar transfers did not subsequently take place.

Another fact material to the different result reached by the Eighth Circuit is its further finding:

It is quite true that it was necessary for the taxpayer to purchase the Class C stock in order to maintain its eligibility to borrow from the Bank. . . . The stock a cooperative is required to purchase serves the additional purpose of being collateral for loans made.

These findings of fact in *M.F.A. Central Cooperative*, whether they be (a) erroneous upon the record in that case and hence a basis for the writ of certiorari asked by the taxpayer or (b) justified by the record as contended by the United States, cannot justify the granting of a writ of certiorari in this case at bar. To the extent that a conflict appears, the holding of the Court of Appeals for the Eighth Circuit is dicta.

Mississippi Chemical Corporation Case

Contrasted to the facts as found by the Eighth Circuit, the Court in the case at bar found as follows:

Mississippi Chemical Corporation acquired its qualifying share of Class C stock in 1956; Coastal Chemical Corporation purchased its share in 1957. Each carried its initial share on its books at the \$100 cost, and neither sought a deduction for any part of this expense. These qualifying shares were not involved in the suit below.

Central to the district court's decision was its finding that the Class C stock, while not worthless, was without any appreciable market value and had at most a nominal value. This conclusion is attributable to the peculiar nature of these shares. Taxpayers could only sell or transfer Class C stock to another qualified farmers' cooperative with the authorization of the Bank's Board of Directors and the approval of the Farm Credit Administration. No share of the Bank's Class C stock has ever been sold by a cooperative, so there is obviously no market in this stock that would aid evaluation.

Additional characteristics of the stock severely limit its value in the hands of the taxpayers. It pays no dividend and has no growth potential. After the purchase of their initial, qualifying shares, taxpayers gained no voting rights by the purchase of additional Class C stock. The Bank has a first lien on all Class C shares. While the governing legislation provides that Class C shares may be retired at some date in the future, retirement will be at par (\$100) and must await the prior retirement of all Class A stock and all senior Class B shares. Retirement is also subject to the discretion of officials of the bank system. Until this uncertain retirement date, the shares have no value to taxpayers in the usual sense. The Bank will not accept Class C shares in satisfaction of future "interest override" obligations, nor will it accept Class C shares as collateral for a loan. These factors, the limited marketability and limited value of the shares themselves, make application of the normal "willing buyer and willing seller" standard, for determining fair market value, unfeasible.

The government appears to concede that these shares have no market value, but urges that they possess an "intrinsic" or "intangible" value in taxpayers' hands which renders their cost a capital investment. First it contends that taxpayers benefit from low cost loans and other Bank services because of the existence of the banking system assured through their continued

purchases of Class C stock. As has been noted, however, the right to Bank services is established by the purchase of the initial qualifying shares.

The above quotations from the Courts of Appeal for the Fifth Circuit and the Eighth Circuit and from the Court of Claims are sufficient to demonstrate the entirely different factual situations which existed concerning the value of the entries upon the books of each separate bank for cooperatives.

The United States refers to the twelve regional banks for cooperatives as if they were comparable institutions from the viewpoint of financial worth and in relation to the value of their Class C stock or credits entered as such. We will not burden this Response with quotations of the evidence demonstrating the vast differences in the financial structure of the several banks which support the finding of these three Courts of different values attributable to "entries" or "stock" of similar nature. However, as a demonstration of the difference in the financial worth (and in the value of Class C stock or entries so designated) of the two banks particularly here involved, we point out that in 1956 there was outstanding Class A stock of the St. Louis Bank for Cooperatives in the amount of \$10,457,000, and Class B stock in said Bank in the amount of \$2,223,200. Both of these stocks are senior to and receive preference over the Class C stock. In 1967 there was no Class A stock outstanding in the St. Louis Bank (all having been theretofore retired) and the amount of Class B stock outstanding had been reduced to \$697,900. Contrasted to this situation (we do not have in the record the exact years involved but the financial worth and the value of Class C stock is illustrated by these facts which do appear in the record) the New Orleans Bank for Cooper-

atives had outstanding in 1956 Class A stock in the amount of \$6,928,100 and Class B stock in the amount of \$360,460. The Class A stock outstanding in 1963 had been reduced to \$4,880,000 and the Class B stock outstanding had been increased to \$399,562. Necessarily, the status of Class C stock of each of the twelve regional banks for cooperatives stands on its own facts. Values attributable to Class C stock in one bank can have no relationship to the values attributable to similar stock in another bank.

CONCLUSION

In conclusion we submit that there does not exist a conflict between the Court of Appeals for the Eighth Circuit (on the one hand) and the Court of Claims and the Court of Appeals for the Fifth Circuit (on the other hand). The different results were reached upon different factual situations.

We vigorously urge that, if the Court does consider it appropriate to grant the Petition for Writ of Certiorari filed in the case at bar, the suggestion of the Solicitor General, quoted below, should not be followed:

If the Court grants the petition in *M.F.A. Central Cooperative*, as we urge it should, we suggest that action on the instant petition be deferred pending the outcome of that case, and that this case be disposed of in accordance with the decision in *M.F.A. Central Cooperative*.

It would be unjust and would deny these taxpayers an opportunity to be heard if the matter were presented to this Court by the M.F.A. Central Cooperative, Inc. upon its record and no opportunity whatever were granted to the taxpayers in the case at bar to appear before this

Court and to be heard in accordance with due process of law.

Respectfully submitted,

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APPENDIX A

PENN YAN AGWAY COOPERATIVE, INC.

v.

The UNITED STATES.

No. 56-66.

United States Court of Claims.

Nov. 14, 1969.

**Before COWEN, Chief Judge, and LARAMORE, DUR-
FEE, DAVIS, COLLINS, SKELTON and NICHOLS, Judges.**
OPINION

PER CURIAM:

This case was referred to Trial Commissioner Ronald A. Hogenson with directions to make findings of fact and recommendation for conclusions of law under the order of reference and Rule 57(a) [since September 1, 1969, Rule 134(h)]. The commissioner has done so in an opinion and report filed on November 20, 1968. Defendant requested the court to adopt the commissioner's findings of fact with the exception of Finding 45 and excepted to his recommended conclusion of law. The case has been submitted to the court on oral argument of counsel and the briefs of the parties. Since the court agrees with the commissioner's opinion, findings and recommended conclusion of law, with slight additions, as hereinafter set forth, it hereby adopts the same as the basis for its judgment in this case. Therefore, plaintiff is entitled to recover and judgment is entered for plaintiff in the sum of \$113 plus interest as provided by law.

Commissioner Hogenson's opinion, as modified by the additions of the court, is as follows:

Plaintiff seeks a ruling in this case that in the computation of its federal income tax liability for the taxable year ending June 30, 1959, it is entitled to deduct, as interest under § 163 of the Internal Revenue Code of 1954, or as ordinary and necessary business expense under § 162, the amount by which its payment that year to the Springfield Bank for Cooperatives for 4.07 shares of class C stock of that bank exceeded the fair market value of such stock at that time. Plaintiff paid \$100 per share, or \$407. The fair market value was \$6.90 per share, or \$28.08. Thus, the claimed deduction amounts to \$378.92. If plaintiff is entitled to the deduction, judgment should be entered for plaintiff in the sum of \$113, plus interest as provided by law.

Defendant's position is that the purchase of the 4.07 shares of the class C stock was a capital investment in the Springfield Bank for Cooperatives under §§ 118 and 1221 of the Internal Revenue Code of 1954, that no disposition of such stock has been made by plaintiff, that a deductible expense or loss did not occur, and that plaintiff's petition should be dismissed.

For the reasons hereinafter stated, it is my opinion that plaintiff is entitled to recover.

Plaintiff, a New York corporation, is and was a farmers' purchasing cooperative. Just prior to the commencement of its 1959 fiscal year, plaintiff borrowed \$75,000 from the Springfield Bank for Cooperatives, Springfield, Massachusetts. In accordance with the two loan agreements involved, plaintiff executed and delivered to the bank its two promissory notes, each for \$37,500, and received from the bank \$74,900 in cash and one share of the bank's class C stock of \$100 par value. This one share (not part of the 4.07 shares upon which plaintiff's claim

is based) was that required by statute, 12 U.S.C. § 1134d (a) (3), to qualify plaintiff cooperative to borrow from the bank. Obviously, plaintiff had not acquired any of such stock previously.

During its fiscal year 1959, plaintiff was required to purchase from the bank 4.07 additional shares of the bank's class C stock at the par value of \$100 per share. This requirement was provided by the cited statute and the terms of the loan agreements, which stated that the borrowing cooperative had to purchase such stock in an amount equal to not less than 10 or more than 25 percent, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by the borrower to the bank for each calendar quarter. For the period of time involved herein, the rate of purchase had been duly fixed at 15 percent. Accordingly, plaintiff during the pertinent fiscal year paid \$407 to the bank (being 15 percent of its interest obligations on the pertinent loans during that time) and received 4.07 shares of the bank's class C stock at par value of \$100 each.

The 4.07 shares of class C stock are and were carried on plaintiff's financial records in an asset account entitled "Investments—Bank for Cooperatives." In its annual reports to stockholders, the Springfield Bank has consistently described the purchase and ownership of class C stock by its borrowing cooperatives as investment capital.

The Springfield Bank for Cooperatives is one of 12 regional banks, which together with the Central Bank for Cooperatives, comprise a system of banks for cooperatives operated since 1933 under charters issued by the Farm Credit Administration pursuant to statutory authorization.

Prior to the organization of the Farm Credit Administration and the system of banks for cooperatives pursuant to the Farm Credit Act of 1933, 48 Stat. 257, farmers generally as well as farmers' cooperatives had encountered severe difficulties in securing adequate commercial credit at reasonable interest rates. Such problems had not been solved in the administration by the Federal Farm Loan Board of the Federal Farm Loan Act of 1916, 39 Stat. 360, enacted by Congress to provide loans by the Federal land banks on farm mortgage security to farmers and farmers' cooperatives.

To improve and expand the sources of credit at reasonable rates to farmers, and to stimulate the growth and development of farmers' cooperatives, Congress enacted the Farm Credit Act of 1933, *supra*, pursuant to which, the system of banks for cooperatives was established as part of the overall structure of the Farm Credit Administration. This agency in considerably expanded form succeeded to the functions of the previous Federal Farm Loan Board.

The capital of the banks for cooperatives was derived from public funds appropriated by Congress, except that additional capital was supplied pursuant to a provision of the founding act that a borrowing cooperative had to purchase \$100 of stock of the lending bank for each \$2,000 borrowed. However, such stock was redeemable on demand at the option of the cooperative upon the payment of the outstanding loan.

Defendant's original capital investment, or stock subscription, in the banks for cooperatives as they were established under the Farm Credit Act of 1933, *supra*, amounted to \$110,000,000, with \$5,000,000 provided to each of the 12 regional banks, and \$50,000,000 to the Central Bank for Cooperatives.

In time, the leaders of the system of banks for cooperatives evolved a plan of retirement of government-owned stock, utilizing the revolving fund method, commonly employed in supplying capital to farmers' cooperatives by its members. In the operation of a farmers' cooperative, usually the members contribute the initial capital, with further contributions being made by each member in succeeding years in proportion to his use of, or benefits received from, the cooperative, and with capital investment being periodically returned to members in order of its contribution.

After a number of years of consideration of such a plan, Congress enacted the Farm Credit Act of 1953, 67 Stat. 390, which established the Federal Farm Credit Board to (a) exercise general direction and supervision over the performance of the system of banks for cooperatives, and to (b) consider and make recommendations to Congress on the best means for eventually retiring the government capital from the Farm Credit System.

Pursuant to the recommendations of the Federal Farm Credit Board, Congress enacted the Farm Credit Act of 1955, 69 Stat. 655, effective January 1, 1956, which provided a comprehensive plan for retirement of government-owned capital from the banks for cooperatives, with the ultimate management, control, and ownership of each bank to become vested in its borrowing cooperatives. The act provided for three classes of stock, each having par value of \$100 per share: Class A for government-owned capital; class B to be issued to private investors; and class C to be issued only to farmers' cooperatives borrowing from the particular bank.

Class A stock could be issued only to the Governor of the Farm Credit Administration on behalf of the United

States. It was nonvoting and no dividends could be paid thereon. Each regional bank was required to retire each year an amount of class A stock at least equivalent to the amount of class C stock issued for that year, with some exceptions not of great moment in this case.

As provided by the act, class B stock could be issued at par to any person. It was nonvoting and could pay dividends of not to exceed 4 percent per annum of its par value. It could be called for retirement at par, in the order of its issuance, but only after the retirement of all class A stock.

As provided by the act, class C stock, except upon authorization of the board of directors of the issuing bank and approval of the Farm Credit Administration, could be issued or transferred only to farmers' cooperatives. It could be issued at no more than its \$100 par value and could pay no dividends. Each holder of class C stock was entitled to no more than one vote, regardless of the number of shares held.¹ Each borrower from a bank was required to own at the time the loan was made at least one share of class C stock, and was also required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 percent, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by it to the bank during the calendar quarter. In the discretion of the board of directors of the bank, class C stock could be retired at par, in the order of its

1. The principle of one vote per shareholder, regardless of the number of shares held, is characteristic of farmers' cooperative organizations, in conformity with the Capper-Volstead Cooperative Marketing Associations Act, 42 Stat. 388, which exempted farmers and their cooperative marketing associations from prosecution for acting in restraint of trade, provided *inter alia* that no member of such a cooperative be allowed more than one vote, regardless of the amount of stock held by him.

issuance. But class C stock issued for any fiscal year could be retired only after all class A stock had been retired, and all class B stock issued during or prior to that fiscal year had been called for retirement. Each regional bank had a first lien on class C stock as collateral for the owner's indebtedness to the bank, and could retire the class C stock of a defaulting borrower, at par, in total or partial liquidation of such indebtedness.

The overall purpose of the act was to accomplish retirement of all class A and B stock, after which the oldest class C stock (in order of its issuance) would be retired, as new class C stock was issued to borrowing cooperatives, and a revolving fund method of capitalization would be fully established. 2 U.S.C. Cong. & Admin. News, p. 2957, 84th Cong., 1st Sess., 1955.

Congress intended that the class C stock would be the voting, common stock of each bank, 2 U.S.C. Cong. & Admin. News, supra, at pp. 2955-2956, and provided in the act that any holder of such stock shall not be entitled to vote, if it has not been a borrower from the bank within the period of two years next preceding a date, fixed by the Farm Credit Administration, prior to the commencement of voting. Since the class A and class B stockholders have no voting rights, the class C stockholders are the only ones with power to elect members to the board of directors of the bank. Prior to 1964, the holders of class C stock of each bank could elect only one of its seven directors, and since 1964, they have elected two of the seven. The other five directors are elected by the local district Production Credit Associations (two members), and the local district Federal Land Bank Associations (two members), with the seventh being appointed by the Governor of the Farm Credit Administration.

The rate of interest charged to plaintiff by the Springfield Bank on the pertinent loan transactions (as stated in the loan documents) was 4.75 percent per annum. This was exclusive of the 15 percent assessment on payable interest for purchase of class C stock. Such assessment could be considered in whole or in part as additional interest by way of a surcharge on the basic interest rate, or as an ordinary and necessary business expense, or as a measurement of the statutory obligation of a borrowing cooperative to invest capital in the lending bank for co-operatives.

The 15 percent surcharge on interest, if the stock purchase assessment be considered that, would increase the basic interest rate of 4.75 percent by 0.7125 to 5.4625 percent per annum. Since plaintiff concedes that 6.9 percent of the cost of each of the pertinent shares of stock (the \$6.90 market value of each share paid for at \$100 par value) was not deductible interest or expense, the surcharge on interest (under plaintiff's theory) would be 93.1 percent of the 15 percent assessment, thus increasing the basic interest rate of 4.75 by 0.6633 to 5.4133 percent per annum.

Since their organization in 1933, the banks for co-operatives have consistently provided lower rates of interest to farmers' cooperatives than could have been obtained on similar loans at commercial banks. For the year 1960 (there being no specific evidence in the record for 1959), the comparative annual interest charges on loans to farm customers were respectively on mortgage and production loans: 4.75 and 5.75 percent by banks for cooperatives, and 6 and 6.9 percent by commercial banks.

It is obvious that even with the addition of the above-described 15 percent surcharge on the basic inter-

est rate of 4.75 percent, plaintiff obtained a lesser rate of interest from the Springfield Bank than it could have obtained from a commercial bank, because plaintiff calculated the comparative cost of borrowing from the Springfield Bank vis-a-vis a commercial bank, and took into consideration that the requirement of purchasing class C stock (to the extent of 15 percent of interest payable on cooperative bank loans) was a loss of use of funds and that such expenditures were an added cost factor over and above the basic rate provided by the Springfield Bank. Furthermore, from the overall policy of the banks for cooperatives, guided by the Farm Credit Administration in expression of the will of Congress, it can be inferred that more favorable interest rates as compared to commercial credit rates have been and will continue to be provided by such banks to farmers' cooperatives, even adding the cost of the required purchase of class C stock on the theory that such cost is an increase of or a surcharge upon the basic interest rates provided by such banks. Plaintiff did not receive any special services other than the lending of money from the Springfield Bank.

As in the case of all the banks for cooperatives, the profits of the Springfield Bank, to the extent they exceeded certain amounts of reserves specified by statute, were required by law to be distributed to borrowers as patronage refunds, in the form of class C stock, not in proportion to the class C stock owned by each borrower, but in the proportion that the amount of interest on the loans of each borrower bore to the total interest earned by the bank on the loans of all borrowers during the fiscal year. This was in accordance with the cooperative principle that those who make use of the cooperative's facilities, and hence, bear the costs of operation, should be able to reduce their costs by receiving a portion of the cooperative's profits allocated on a patronage or use basis.

For its share of the distributed profits of the Springfield Bank for the fiscal year ending June 30, 1959, plaintiff received 9.76 shares of class C stock.

However, except for the right ultimately to receive their par value on redemption, the 4.07 shares of class C stock involved in plaintiff's claim did not entitle plaintiff to any benefit which plaintiff did not already enjoy by reason of having acquired in 1958 the single qualifying share required by law in order to permit it to borrow from the bank. The 4.07 shares gave plaintiff no additional voting rights, no additional right to share in the profits of the bank, and no additional benefits of any kind.

As of December 31, 1955, defendant had \$6,600,000 invested in the Springfield Bank for Cooperatives, for which class A stock was issued. From January 1, 1956, the effective date of the act authorizing the three classes of stock, to June 30, 1959, defendant's holding of class A stock was reduced by \$875,600 by redemption by the bank of class A stock in that amount. The retirement rate was about \$245,000 per year during that period of time. As of June 30, 1959, there was no evidence of any trend toward a larger retirement rate.

As of June 30, 1958, the Springfield Bank had issued and outstanding about \$7,800,000 par value of class A, B, and C stock, all of which would have had to be retired before any of the class C stock issued in fiscal year 1959. Thus, plaintiff's 4.07 shares of class C stock acquired in that year would be reached for retirement in 30 to 31 years at the experienced retirement rate of \$245,000 per year of the previously issued stock.

Plaintiff now owns and has continued to own the 4.07 shares of class C stock ever since acquired from the Spring-

field Bank in the taxable year involved. There have been no sales of class C stock other than issuance by a bank for cooperatives to a borrowing farmers' cooperative. As stated above, such stock could be issued or transferred only to a farmers' cooperative, except upon authorization of the bank's board of directors with approval of the Farm Credit Administration. There is no evidence that approval could be obtained of a sale to any investor other than a cooperative, and it is not shown that any cooperative would have been willing to buy plaintiff's 4.07 shares at any satisfactory price. Plaintiff reasonably believed that there was no market for such stock.

The fair market value of plaintiff's 4.07 shares of class C stock was established at \$6.90 per share as of the time of its acquisition by plaintiff in 1959 by expert stock evaluation testimony adduced by plaintiff. Assuming correctly that no dividends could be paid on such stock, and that no sales had occurred, the experts concluded that the willing buyer would be an investor who would know that he would realize no return upon such stock except its \$100 par value upon its retirement in 30 or 31 years, that such an investor, in accordance with historical experience in trading in common stocks, would expect a return (including dividends and appreciation in value) of 9 to 10 percent compounded annually on an investment in common stocks at that time, and that the sales price of \$6.90 per share compounded annually at such a rate would amount to the \$100 which would be returned to such investor in 30 to 31 years.

Defendant's basic position is that the legislative history and the statutory method of providing capital to the banks for cooperatives by use of the revolving fund principle demonstrate that plaintiff's purchase of the 4.07 shares of class C stock was intended by Congress, the

bank, and plaintiff to be a capital investment, and that such stock is and was a capital asset acquired and held by plaintiff under § 1221 of the Internal Revenue Code of 1954.

Defendant ascribes a full value of \$100 per share as of the time of plaintiff's acquisition of such stock on the illusory argument that such value is established by (1) the "extremely valuable intangible benefit" which all member cooperatives (including plaintiff among all others) received from the system of banks for cooperatives, i.e.; the right to borrow large sums of money over long periods of time at low interest rates, as contrasted with rates available at commercial banks; (2) the alleged impossibility of assigning a "determinable market value" to such stock because of its special characteristics; and (3) the fairness for tax purposes of awaiting the realization of the \$100 per share proceeds of redemption, since plaintiff's method of valuation was a "discounting of the redemption value" to \$6.90 per share "based upon a speculation as to when it would be redeemed and a hypothetical discount factor derived from other unrelated investments."

But the cold fact remains that when plaintiff paid the \$407 for the 4.07 shares, it received stock which was greatly less valuable from an economic and financial standpoint than the purchase price required by law and the terms of the loan agreements. The "intangible benefits" bestowed by Congress on farmers' cooperatives generally do not alter this fact. As reasonable management of the business would be expected to do, plaintiff considered the long delay in recovery of the purchase price of such no-dividend stock as a loss of use of funds in calculating the comparative loan costs from the Springfield Bank vis-a-vis a commercial bank. The required purchase of such stock gave plaintiff no economic or financial benefit other

than the circumstance that it could not have obtained the loan with its favorable interest rate without fulfillment of the statutory requirement. But in the extremely practical field of taxation, in which substance prevails over form, it cannot reasonably be concluded under the circumstances that Congress has granted favors to cooperatives in furtherance of agricultural policies and taken them away (on the theory of intangible benefits) in whole or in part in the field of raising of public revenues. It is obvious under the facts of this case that plaintiff did not consider, nor could it reasonably be held to have considered, that its required payment of \$407 for such stock, was an investment, as no return on such purported investment could be realized, except repayment of the bare purchase price delayed for many years.

Of course, Congress considered the 15 percent surcharge on interest payable on loans as a means of providing capital to the banks for cooperatives, and the bank realistically and lawfully treated as capital, funds received in that manner. But from the standpoint of plaintiff-taxpayer, this was in reality an increase of the basic interest rate as an experienced cost of borrowing money from the bank, even described in the statute and in the loan agreements as a percentage of interest payable on the loans. Its expenditure of \$407, at least in greater part, was in reality an item of cost of conducting its business, and in the absence of compelling law to the contrary, and to the extent that it was a reasonably ascertainable cost, should be offset against plaintiff's income in the taxable year involved, in accordance with the annual accounting principle of the federal income tax laws. This is true whether such ascertainable cost is deemed interest paid under § 163 or an ordinary and necessary business expense under § 162 of the Internal Revenue Code of 1954.

[1, 2] It is a well established rule of law, carefully analyzed and stated in *Drybrough v. United States*, 208 F.Supp. 279 (W.D. Ky. 1962), that the market value of common stock in a closely held corporation, there being no market sales of such stock, must be determined upon consideration of all relevant factors, such as earning capacity, anticipated profits, book value, and dividend yield. Obviously, the relevant factors concerning the value of plaintiff's 4.07 shares of class C stock are extremely limited. The only right they carry and have carried is long-delayed redemption at their bare purchase price. But the difficulties inherent in determining their fair market value should not be permitted to defeat a fair and just decision in this case, and consequently plaintiff's evaluation of its 4.07 shares is accepted as the most an investor (which apparently would have to be another farmers' cooperative) would pay, if such a purchaser could be found. Defendant did not offer any evidence to the effect that plaintiff's experts used a discount rate which was more than reasonable, and its expert testimony was that the pertinent stock had a value of \$100 per share, unsupported unless defendant's theory of intangible benefits be sustained.

Of course, plaintiff had a right to participate in a division of the assets of the Springfield Bank in the event of its dissolution and liquidation prior to the redemption of plaintiff's stock. But such an event is and was extremely unlikely for various obvious reasons, including unlikely abandonment by Congress of firmly established agricultural policy and the fact that the Springfield Bank and the other banks for cooperatives were jointly and severally liable on \$284,500,000 of consolidated debentures issued by such banks. Furthermore, each of such banks has powerful safeguards against financial difficulty

by delaying without cost (in the exercise of their statutory discretion) the redemption of class C stock, by increasing within the statutory limits the required purchase of new class C stock up to 25 percent of interest payable on new loans, and by increasing the basic interest rate on new loans, in line with any increases in commercial credit rates, all without being required to distribute any dividends (other than class C stock) to its stockholders, and then only on a patronage or use basis.

Defendant stresses the fact that plaintiff has continued to own the 4.07 shares of stock ever since acquired from the bank, and argues that this fact distinguishes this case from various cases relied upon by plaintiff. Defendant's position is that even if it is decided that plaintiff acquired the stock when it had a value of \$6.90 per share, at a price of \$100 per share, such a bad bargain does not give rise to a deductible loss or business expense, but the tax consequences must await the disposition of such assets. Defendant relies upon *Montana Power Co. v. United States*, 159 F.Supp. 593, 595, 141 Ct.Cl. 620, 623-624, cert. denied, 358 U.S. 842, 79 S.Ct. 23, 3 L.Ed. 2d 76 (1958); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916, 922, 157 Ct.Cl. 886, 896-897 (1962); *Chase Candy Co. v. United States*, 126 F.Supp. 521, 130 Ct.Cl. 102 (1954); *Koppers Co., Inc. v. United States*, 278 F.2d 946, 949, 150 Ct.Cl. 556, 560 (1960). But defendant's interpretation of such cases, whether such a holding be expressed or implied therein, cannot reasonably be applied under the facts of the instant case. In my opinion, it would be unfair and unjust to apply such a doctrine in the circumstances where disposition by plaintiff of the class C stock was a practical impossibility due to lack of a market, which resulted from the statutory restrictions placed upon such stock under the capitalization formula prescribed by law for the banks for cooperatives.

A bonus or premium paid by a taxpayer to induce a loan has been held to be deductible as interest within the meaning of the pertinent section of the federal income tax statutes. *Wiggin Terminals, Inc. v. United States*, 36 F.2d 893 (1st Cir. 1929) (Payment of \$50,000 cash bonus); *L-R Heat Treating Co.*, 28 T.C. 894 (1957) (\$61,200 withheld from amounts paid to borrower as premiums for making loans); *Court Holding Co. v. Commissioner*, 2 T.C. 531, 536 (1943), rev'd on other grounds, 143 F.2d 823 (5th Cir. 1944), circuit court rev'd and tax court aff'd on the other grounds, 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 567 (1945) (Payment of \$350 cash bonus). In each of these cases, the borrower in effect parted with additional money, over and above the agreed interest rate, and for such additional payments, received nothing in return other than the use of the lender's money.

In *Wiggin, supra*, the payment of the bonus over and above the agreed interest rate was accomplished by the borrower issuing stock to the lender for a temporary period and paying dividends thereon equal to the bonus agreed upon, but the court held that it made no difference what the reason was for paying in that form, and ruled that the real character of the payment of the dividends was interest, according to the intent of the parties.

Universally accepted in cases involving the applicability of usury laws is the general principle, stated in *Oil City Motor Co. v. C.I.T. Corp.*, 76 F.2d 589, 591, 104 A.L.R. 240 (10th Cir. 1935), and in *Memorial Gardens of Wasatch, Inc. v. Everett Vinson & Associates*, 264 F.2d 282, 285 (10th Cir. 1959), as follows:

* * * The familiar doctrine is invoked that, if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value

or to purchase property from him at an excessive price, the difference represents interest and will be taken into account in determining whether the transaction is usurious. * * *

In the application of this rule, it would seem clear that if the lender required the borrower to purchase common stocks at a price greater than its market value, as a part of the loan transaction, the excess of the price over the market value would be deemed interest in the case involving usury laws.

Plaintiff relies heavily upon *Ancel Greene & Co.*, 38 T.C. 125 (1962), asserting that it is "square authority for the deduction claimed by plaintiff" herein; and also upon *McMillan Mortgage Co.*, 36 T.C. 924 (1961).

In *Ancel Greene*, taxpayer was engaged in buying, selling, and servicing real estate mortgages, and sold mortgages to the Federal National Mortgage Association (FNMA), created by Congress and operating with government-owned capital, as a secondary market facility for home mortgages. By statute, 12 U.S.C. § 1718(a) and (b), FNMA was required to accumulate funds for its capital surplus account from private sources by requiring each mortgage seller to make payments of nonrefundable capital contributions, measured by a percentage of the unpaid principal amounts of mortgages purchased, and to issue its common stock for such contributions. In each of the mortgage sales agreements, reached in each of the three successive taxable years in suit, taxpayer subscribed to such stock and agreed to have FNMA deduct from the sales price for the mortgages the purchase price of the stock, i. e., its par value of \$100 per share. Such stock was actively traded, and during the taxable years in suit had a market value varying from \$40.50 to \$63 per share. In computing taxable income, taxpayer deducted as ordi-

nary and necessary expense of doing business, the difference between the amount paid to FNMA for such stock and the market value thereof. Such deductions having been disallowed by the Internal Revenue Service, the issue as stated by the court was whether any portion of the purchase price of the stock, withheld by FNMA from the sales price of the mortgages, is *not includible* or is *deductible* from taxpayer's income. Holding for taxpayer and against Internal Revenue that the sale of mortgages and the purchase of the FNMA stock constituted a single and inseparable transaction, the court concluded that the taxpayer was required to include in income, receipts from the mortgages sold to FNMA plus the fair market value of the FNMA stock. In effect, the court answered the issue as stated, by allowing as a deduction that which had been claimed in the taxpayer's returns, i. e., the difference between the amount paid to FNMA for such stock and its fair market value at the time. The court thus rejected the position of Internal Revenue that the pertinent stock was a capital asset with a cost basis of \$100 per share, at least to the extent to which its cost exceeded its fair market value.

Contrary to any of the language used by the court, defendant construes the holding of the court in *Ancel Greene* to amount to the allowance of an ordinary loss on the sales of the mortgages.

The court further found in *Ancel Greene* that taxpayer held substantial portions of the stock for periods in excess of a year and a half and at the end of the last fiscal year² in suit was still holding some stock which had been held by it for over 2½ years.² As in the instant case,

2. It is obvious that the tax court allowed deductions from income with respect to FNMA stock which the taxpayer purchased during but still held after the taxable years in suit, and thus impliedly held that the tax treatment accorded was not dependent upon a sale or exchange of such stock by the taxpayer.

taxpayer carried the pertinent stock in an investment account in its financial records. In the absence of any other evidence, the court assumed that taxpayer held such stock as an investment either for receipt of dividends payable thereon or in the hope that the market price would increase. On the second issue in the case, the court held that the shares of FNMA stock were capital assets when sold by taxpayer, ruling, however, that gain or loss upon such sales was to be computed by using as the basis for each share of stock sold, the fair market value of such share at the date of its issuance to taxpayer.

Also in *Ancel Greene*, the tax court correctly commented that the facts with respect to acquisition of FNMA stock were identical except as to amounts and dates with those in *McMillan Co.*, *supra*, but that the facts with respect to the carrying and holding of the stock differed in the two cases. In *McMillan Co.*, the FNMA stock was held by the taxpayer for relatively short periods of time, when a market existed for such stock, and with no intent to hold such stock as an investment.

In the instant case, the class C stock has been held by plaintiff for a substantial period of time, when no market existed, with no intent to hold such stock as an investment.

In *McMillan Co.*, *supra*, the facts were identical with those in *Ancel Greene*, except that the taxpayer did not treat its FNMA stock holdings on its books and records as investments or capital assets, but rather as current assets, recording gain or loss on its sales of such stock as ordinary gain or loss. Furthermore, all shares of such stock were sold or otherwise disposed of within 6 months after their acquisition, with a large number within 60 days. Taxpayer in its contested tax returns treated its

dispositions of the stock as ordinary gains or losses, with deficiencies assessed by the Internal Revenue Service on the theory that taxpayer's FNMA stock acquisitions were not purchases of inventory items but of capital assets; that the basis of such stock was its cost of \$100 per share, irrespective of its fair market value; and that gain or loss upon subsequent disposition of such stock constituted a capital gain or loss, and not a deductible business expense. The court stated the issue to be whether such shares of stock were capital assets in the hands of the taxpayer, and sustained taxpayer's position that the FNMA stock in its hands was within the first exclusion from the definition of a capital asset contained in § 1221 of the Internal Revenue Code of 1954, as follows:

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

The court reasoned that in the conduct of its business the taxpayer first resorted to the private investors' market, but when funds were not available there, turned to the secondary market (FNMA) provided by law for just such purpose, that the FNMA transactions were entered into in the ordinary course of taxpayer's business of marketing its mortgages, that as an integral and essential part of dealing with FNMA, it was required to take part of the proceeds of sale of mortgages to FNMA in FNMA stock at par value, and that it held such stock for sale in the conduct of its business, as shown by its prompt sales thereof, and also by the fact that it would have been unreasonable for taxpayer to have kept funds tied up in such stock when presumably it was the need for liquidity which compelled the sale to FNMA under less favorable terms

than in the primary market. The court held that taxpayer's acquisition of such stock and its sale was a normal business activity incident to taxpayer's business, that such stock was not a capital asset, and that taxpayer's "expenditures (whether considered to be expenditures of cash or expenditures of part of the agreed price of mortgages) were necessary expenditures of the business and hence the amount was a deductible item." 36 T.C. at 933.

In *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D.Mo. June 14, 1968), now on appeal to the Eighth Circuit Court of Appeals, the district court held that the class C stock, required to be purchased by taxpayer cooperative from the St. Louis Bank for Cooperatives in an amount equal to 15 percent of interest payable by such cooperative to the bank on its outstanding loans, did not have any fair market value at the time of its issue, that the purchase price paid for such stock was not interest, but that such price was deductible as ordinary and necessary business expense.

On the interest issue, the district court distinguished the above-cited *Wiggin Terminals*, *L-R Heat Treating*, and *Court Holding* cases on the grounds that in such cases, the debtor parted with additional money in the

3. In Section 8 of Public Law No. 86-779, 86th Cong., 2d Sess., September 14, 1960, 1960-2 Cum.Bull. 709, 713, Congress added § 162(d) to the Internal Revenue Code of 1954, effective for taxable years beginning after 1959, which specifically provides that whenever the amount of required capital contributions to FNMA exceeds the fair market value of the FNMA stock as of its issue date, the purchaser of such stock shall treat the excess as deductible ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. The Committee reports expressly stated that "Viewed from such a taxpayer's standpoint, the excess appears clearly to be expenditures which he must incur in order to sell the mortgage paper he holds." H.R.Rep.No. 1662, 86th Cong. 2d Sess. 3 (1960), 1960-2 C.B. 816, 818; S.Rep.No. 1767, 86th Cong. 2d Sess. 8 (1960), 1960-2 C.B. 829, 834. This legislative characterization precisely fits the situation in the instant case.

form of a bonus or premium and received nothing in return other than use of the lender's money, whereas in the case under consideration, *M.F.A. Central Cooperative* received class C stock for the additional money.

In support of its decision that the purchase price of such stock was an ordinary and necessary business expense, the district court analyzed the facts and circumstances involved, and concluded that the class C stock was of absolutely no use or benefit to the taxpayer, and that the only reason it was purchased was because taxpayer wanted to borrow money from the bank for co-operatives, and the agreement to purchase such stock was imposed as a condition of the loan.

While there is considerable merit in the district court's reliance on the theory of deductible expense, it is my opinion that the more logical basis for allowance of the claimed deduction in this case under all of the facts and circumstances is that the purchase price of the class C stock (to the extent that such price exceeded the market value of such stock, as such value is conceded by plaintiff) was interest paid and deductible under § 163 of the Internal Revenue Code of 1954, particularly because the amount of such stock required to be purchased by law and by the loan agreements involved was measured by a percentage of the interest payable on plaintiff's outstanding loan obligations to the bank issuing the stock. It is held that plaintiff's claimed deduction is allowable as interest paid.⁴

4. *Mississippi Chemical Corp. v. United States*, S.D.Miss. decided February 14, 1969, 69-1 U.S.T.C., par. 9266, now on appeal to the Court of Appeals for the Fifth Circuit, has recently held the same deduction allowable as interest.

APPENDIX B

In the United States Court of Appeals
for the Fifth Circuit

No. 28271

MISSISSIPPI CHEMICAL CORPORATION;
PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

COASTAL CHEMICAL CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*Appeals from the United States District Court for the
Southern District of Mississippi*

(September 14, 1970)

BEFORE GEWIN, GODBOLD and CLARK, Circuit Judges.

· GEWIN, Circuit Judge: The government appeals from separate judgments entered for Mississippi Chemical Corporation and Coastal Chemical Corporation (hereinafter, taxpayers) in their suits for refund of federal taxes. Taxpayers based their claims for refund on the contention that \$99 of each \$100 expended for the purchase of certain Class C stock in the New Orleans Bank for Cooperatives constituted deductible expenses in the year of purchase. The government contended that these amounts were the

non-deductible costs of acquiring capital assets. The district court concluded that the payments were deductible as interest expenses, and we affirm.

Taxpayers are Mississippi corporations with their principal place of business in Yazoo City, Mississippi. During the tax years in question they were "cooperative associations" as defined in the Agricultural Marketing Act.¹ Taxpayers are stockholders in, and borrowers from, the New Orleans Bank for Cooperatives (hereinafter, the Bank). The Bank is part of a banking system created by the federal government² during the depression to provide low cost loans to farmer's marketing, purchasing, and service cooperatives. It is one of the twelve regional banks in the system and serves Louisiana, Mississippi, and Alabama.

The governing legislation³ provides for three classes of stock in a regional bank. Class A stock represents the original capital contributed by the United States. These shares are non-voting and pay no dividend. The legislation contains a scheme of retirement for Class A shares which is dependent on the amount of Class C stock purchased and on the net profits of the regional bank. Class B stock may be issued to any person. It is non-voting but may bear a dividend not to exceed four percent per annum. Class C stock may only be issued to banks for cooperatives and to farmers' cooperative associations. It pays no dividend. Each holder of Class C stock is entitled to one vote, though a cooperative has only the single vote regardless of the number of Class C shares held.

Farmers cooperatives, like taxpayers, acquire Class C shares in three ways: (1) Each cooperative must pur-

1. 12 U.S.C. § 1141(j).
2. 12 U.S.C. § 1134.
3. 12 U.S.C. § 1134(d).

chase a qualifying share of Class C stock to be eligible to borrow from the Bank. (2) A borrower cooperative is required to make quarterly investments in Class C stock; these purchases are referred to as "interest override" payments. The amount required to be invested is not less than ten nor more than twenty-five percent of the interest payable by the borrower for that quarter, to be determined by the Bank's directors.⁴ (3) Class C stock is also received by farmer's cooperatives as a distribution of the Bank's net profits during a fiscal year. These distributions, called "patronage refunds", are computed in amount "in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year."⁵

Mississippi Chemical Corporation acquired its qualifying share of Class C stock in 1956; Coastal Chemical Corporation purchased its share in 1957. Each carried its initial share on its books at the \$100 cost, and neither sought a deduction for any part of this expense. These qualifying shares were not involved in the suit below.

Mississippi Chemical's suit concerned the fiscal years ending 30 June 1961, 1962, and 1963. As a result of its borrowings during those years it was required to make "interest override" purchases of 189, 169, and 193 shares of Class C stock respectively. The purchase price of each share of stock was \$100. In its tax returns for each year, Mississippi Chemical reported \$1 per share as the cost of acquiring a capital asset and claimed a deduction in the amount of \$99 a share as an interest expense. In the same fiscal years, Mississippi Chemical received "patronage refunds" of 287, 275, and 251 shares of Class C stock re-

4. The rate for the New Orleans Bank during the periods in question was 15%.

5. 12 U.S.C. § 1134(1)(b).

spectively. It reported \$1 per share of the "patronage refund" as a reduction of interest expense and investments, but it made no report of the remaining \$99 of par value of each share.

Coastal Chemical's suit involved a longer period of time including the fiscal years ending 30 June 1958 through 1963. In these years Coastal Chemical purchased 118, 339, 473, 417, 351, and 421 shares of Class C stock respectively pursuant to the "interest override" requirements. During the same years, it received 143, 474, 516, 605, 523, and 630 shares of Class C stock as "patronage refunds." In its tax returns for these periods, Coastal Chemical treated the shares purchased and those received as "patronage dividends" in the same manner as Mississippi Chemical.

The Commissioner disallowed the interest deduction claimed by each taxpayer and asserted deficiencies. Taxpayers paid the deficiencies and filed claims for refund which were disallowed. Taxpayers then instituted their actions which were consolidated for trial in the district court. The court below upheld the taxpayer's contention that \$99 of each \$100 expended for the purchase of a share of Class C stock was deductible as an interest expense. In the district court the government also contended that taxpayers should have reported the Class C stock received as patronage refunds as income. The court did not sustain this position and it has been abandoned by the government.⁶ As a result the present appeal is concerned solely

6. In a footnote to its brief the government states:

"The Government also contended in the lower court, that the taxpayers should have reported the patronage dividends (refunds) of shares of Class C stock during the taxable periods in issue as income. The lower court refused to sustain that contention. The Government has not appealed from that part of the judgment."

with the tax treatment of the Class C stock purchased under the "interest override" requirements of 12 U.S.C. § 1134(d) (3)⁷

I

Central to the district court's decision was its finding that the Class C stock,⁸ while not worthless, was without any appreciable market value and had at most a nominal value. This conclusion is attributable to the peculiar nature of these shares. Taxpayers could only sell or transfer Class C stock to another qualified farmers' cooperative with the authorization of the Bank's Board of Directors and the approval of the Farm Credit Administration. No share of the Bank's Class C stock has ever

In this connection the following argument is advanced by amicus curiae:

"By failing to appeal from the decision below that Class "C" stock received as patronage refunds must be included in plaintiffs' income only to the extent of \$1 per share, the government in effect concedes that the fair market value of such stock is no more than \$1 per share. Clearly the same standard must apply in assessing the value of the identical stock which is purchased pursuant to the requirements of a loan agreement."

See *Commissioner v. B. A. Carpenter*, 219 F. 2d 635 (5th Cir. 1955); *Long Poultry Farms v. Commissioner*, 249 F. 2d 726 (4th Cir. 1957); Treas. Reg. § 1.61-5(b) (1) (iv) (1959).

7. The same question has been involved in two recent cases. In *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372 (Ct.Cl. 1969), the Court of Claims held that amounts paid for Class C shares of the Springfield Bank for Cooperatives under the "interest override" requirements were currently deductible as interest. In *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo. 1968), the district court allowed current deduction of the cost of Class C shares in the St. Louis Bank for Cooperatives, but considered it an ordinary and necessary business expense rather than interest. On appeal the Eighth Circuit reversed the district court and held that the cost of Class C shares was not currently deductible. *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527—19,531, June 8, 1970].

8. The New Orleans Bank does not issue certificates for the Class C shares. Thus, Class C shares are really only credits entered on the books of the bank in units of \$100 and fractional parts thereof.

been sold by a cooperative,⁹ so there is obviously no market in this stock that would aid evaluation.

Additional characteristics of the stock severely limit its value in the hands of the taxpayers. It pays no dividend and has no growth potential. After the purchase of their initial, qualifying shares, taxpayers gained no voting rights by the purchase of additional Class C stock. The Bank has a first lien on all Class C shares.¹⁰ While the governing legislation provides that Class C shares may be retired at some date in the future, retirement will be at par (\$100) and must await the prior retirement of all Class A stock and all senior Class B shares. Retirement is also subject to the discretion of officials of the bank system. Until this uncertain retirement date,¹¹ the shares have no value to taxpayers in the usual sense. The Bank will not accept Class C shares in satisfaction of future "interest override" obligations, nor will it accept Class C shares as collateral for a loan. These factors, the limited marketability and limited value of the shares themselves, make application of the normal "willing buyer and willing seller" standard, for determining fair market value,¹² unfeasible.

9. The Bank's Class C shares have changed hands only at the liquidation of a cooperative or its merger with another.

10. 12 U.S.C. § 1134(d) (c).

11. For purpose of valuation, the *Penn Yan* court accepted 30 or 31 years as the period required before the stock would be retired based on the history of the Springfield Bank. It is not clear to what extent this figure reflected the discretion of the bank officials or other factors which could operate to defeat or prolong recovery.

12. [Fair market value] is the price at which property will change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts.

Willow Terrace Dev. Co. v. Commissioner, 345 F. 2d 933, 936 (5th Cir. 1965).

The government appears to concede that these shares have no market value,¹³ but urges that they possess an "intrinsic" or "intangible" value in taxpayers' hands which renders their cost a capital investment. First, it contends that taxpayers benefit from low cost loans and other Bank services because of the existence of the banking system assured through their continued purchases of Class C stock. As has been noted, however, the right to Bank services is established by the purchase of the initial qualifying shares. The government also points to the history of the Banks for Cooperatives¹⁴ which evidences a Congressional intention ultimately to withdraw all government investment from the system. This is to be accomplished by the retirement of Class A stock as the federal investment it represents is replaced by Class C investment through purchases by cooperatives and receipt by them of "patronage refunds." The government urges that when all Class A stock has been retired, the revolving fund method of capitalization, common to cooperative financing, will prevail and the participating cooperatives will be the sole owners of a valuable financial institution. It should be noted that ownership here is not synonymous with control:

Prior to 1964, the holders of Class C stock of each [regional] bank could elect only one of its seven directors, and since 1964, they have elected two of the seven. The other five directors are elected by the local dis-

13. The Government states in its brief:

"In truth, because of the special characteristics of the stock there is no reasonable and determinable market value which can be assigned to it. As one authority puts it [Packel, Law of Cooperatives (3d ed.), Sec. 45(d) at 234.]: The circumstances surrounding the issuance of revolving fund certificates are often such that no particular market value can be ascribed to the certificate even though it refers to a sum certain."

14. The history, organization, and capital structure of the Banks for Cooperatives is discussed by the court in *Penn Yan*, 417 F. 2d at 1373-1376.

strict Production Credit Associations (two members), and the local district Federal Land Bank Associations (two members), with the seventh being appointed by the Governor of the Farm Credit Administration.¹⁵

With their share of control in the Bank thus limited, the fact that Class C shareholders were having capital they supplied substituted for that previously furnished by the government can scarcely be seen as enhancing the value of their shares. In *Penn Yan Agway Cooperative, Inc. v. United States*,¹⁶ the Court of Claims rejected the same government argument—that the Class C shares possessed intangible value. The court stated:

[T]he cold fact remains that when plaintiff cooperative shareholder paid the \$407 for the 4.7 shares, it received stock which was greatly less valuable from an economic and financial standpoint than the purchase price required by law and the terms of the loan agreements. The "intangible benefits" bestowed by Congress on farmers' cooperatives generally do not alter this fact . . . The required purchase of such stock gave plaintiff no economic or financial benefit other than the circumstance that it could not have obtained the loan with its favorable interest rate without fulfillment of the statutory requirement. But in the extremely practical field of taxation, in which substance prevails over form, it cannot reasonably be concluded under the circumstances that Congress has granted favors to cooperatives in furtherance of agricultural policies and taken them away (on the theory of intangible benefits) in whole or part in the field of raising of public revenues. It is obvious under the facts of this case that plaintiff did not consider, nor could it reasonably be held to have considered, that its required payment of \$407 for such stock, was an investment, as no return on such purported investment

15. *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372, 1375 (Ct. Cl. 1969).

16. 417 F. 2d 1372 (Ct. Cl. 1959).

could be realized, except repayment of the bare purchase price delayed for many years.¹⁷

In *Penn Yan*, the cooperative shareholder assigned a value of \$6.90 to its Class C shares and introduced expert testimony tending to support this general figure as a reasonable estimate of the shares' fair market value. The Court of Claims approved the cooperative's evaluation. In *M.F.A. Central Cooperative v. Bookwalter*,¹⁸ the district court concluded that Class C shares in the St. Louis Bank for Cooperatives had no fair market value at all. This conclusion was reversed by the Eighth Circuit which stated, "While the Class C stock has no established market value, it has a substantial book value and while it is likely not worth its par value at the time it is issued, it certainly has substantial value."¹⁹ It should be noted that there is a considerable difference, as to the factors affecting value, between the shares of the St. Louis bank and those involved here.²⁰ In the present case, considering the nature of the Class C stock and the testimony as to its value adduced in the district court, that court was not clearly erroneous in determining that the Class C shares had no fair market value and no more than a nominal value to the taxpayers.²¹

17. *Id.* at 1377-1378.

18. 286 F. Supp. 956 (E.D. Mo. 1968).

19. *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

20. From statements contained in briefs filed in this court, it appears that by June 30, 1967 the St. Louis Bank had completely retired its Class A shares and substantially reduced the amount of Class B investment. As a consequence it was able to redeem all Class C shares issued during the fiscal year ending June 30, 1956. The M.F.A. Cooperative had purchased St. Louis Class C shares from other cooperatives, and it appears that transactions between cooperatives were not uncommon.

21. Rule 52(a) Fed. R. Civ. Pro.

II

Notwithstanding the absence of a fair market value for the Class C shares, the government contends that taxpayers were not entitled to deduct any portion of their purchase price. It cites *Montana Power Co. v. United States*,²² contending:

If one buys something and pays more than it is worth, and more than he can resell it for, there are no immediate tax consequences of this everyday occurrence. . . . He must "realize" his bad bargain, his loss, by selling.

We do not dispute the soundness of this tax principle, but consider it inapplicable to the present case.²³ The government advanced the same argument in the *Penn Yan* case. The Court of Claims rejected it stating:

[I]t would be unfair to apply such a doctrine in the circumstances where disposition by the plaintiff of the class C stock was a practical impossibility due to lack of a market, which resulted from the statutory restrictions placed upon such stock under the capitalization formula prescribed by law for the banks for co-operatives.²⁴

Montana Power and the other cases relied on by the government are readily distinguished from the present situation. Taxpayers in the instant case have not been the victims of a bad bargain in the traditional sense;²⁵ they were required to make continued purchases of Class C

22. 159 F. Supp. 593, 595 (Ct. Cl.), cert. denied, 358 U.S. 842 (1963).

23. See *Ancel Green & Co.*, 38 T.C. 125 (1962); *McMillian Mortgage Co.*, 38 T.C. 924 (1961). These cases are thoroughly discussed in *Penn Yan*, 417 F. 2d at 1380-1381.

24. 417 F. 2d at 1379.

25. See *Montana Power Co. v. United States*, 159 F. Supp. 593 (Ct. Cl. 1958).

stock in order to secure loans from the Bank. Neither did taxpayers acquire an asset of continuing value, though less than the purchase price;²⁶ the Class C shares were of no appreciable value to the taxpayers. It is at odds with the incisive realism required in determining the tax consequences of ambiguous transactions to treat these purchases as "investments"; they were something else.²⁷

We agree with the trial court and with the Court of Claims in *Penn Yan*, that the purchase price of the Class C stock (in excess of the nominal value assigned it by taxpayers) is deductible as interest in the year of purchase. Section 163(a) of the Code²⁸ provides, "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The interest which is deductible under this section is defined as, "the amount one has contracted to pay for the use of borrowed money."²⁹ As we have noted the Class C stock was without practical value to the taxpayers. Their only reason for acquiring the shares was as a prerequisite for continued borrowing from the Bank. It was in effect a bonus or premium paid in addition to the usual interest, and comes within the

26. See *Dresser v. United States*, 55 F. 2d 499, 512 (Ct. Cl.), cert. denied 287 U.S. 635 (1932); *Koppers Co. v. United States*, 278 F. 2d 946, 949 (Ct. Cl. 1960).

27. Our decision on this point appears to be at odds with that of the Eighth Circuit in *M.F.A. Central Cooperative v. Bookwalter*, F. 2d _____ (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970]. Insofar as that court's decision is not attributable to the difference in value of the St. Louis shares, we are simply unable to agree. If we concluded, as did the Eighth Circuit, that the "interest override" payments were made to acquire Class C shares as capital assets, we would agree that recognition of gain or loss must ordinarily await realization through sale or exchange. However, we agree with the court below that, for tax purposes, the bulk of these payments were not *actually* made to acquire an asset.

28. 26 U.S.C. § 163(a).

29. *Old Colony R.R. v. Commissioner*, 284 U.S. 552, 560 (1932).

meaning of interest under 163(a).³⁰ The *Penn Yan* court supported its similar decision with the proposition borrowed from usury cases that:

[I]f as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest. . . .³¹

In M.F.A., the district court held that the amounts paid by the plaintiff cooperative for Class C shares of the St. Louis Bank for Cooperatives were not deductible as interest under § 163(a),³² but allowed a current deduction as an ordinary and necessary business expense under § 162(a).³³ The district court distinguished the cases allowing interest deductions for amounts paid as a bonus or premium to induce a loan,³⁴ since the debtors in those cases received nothing in return for the bonus but the use of the loaned money while the M.F.A. Cooperative had received Class C stock. Because, of the peculiar nature of the Class C shares, we find this distinction unacceptable. As the district court itself observed:

This Classic C stock purchased quarterly was of absolutely no use or benefit to M.F.A. Central Coopera-

30. *Wiggin Terminals, Inc. v. United States*, 36 F. 2d 893 (1st Cir. 1929); *L-R Heat Treating Co.*, 28 T.C. 894 (1957); *Court Holding Co.*, 2 T.C. 531, 536 (1943), *rev'd on other grounds*, 143 F. 2d 823 (5th Cir. 1944), court of appeals *rev'd* and tax court *aff'd* on other grounds, 324 U.S. 331 (1945). These cases are offered for the same proposition by the Court of Claims in *Penn Yan*, 417 F.2d at 1379.

31. 417 F. 2d at 1379; quoting, *Memorial Gardens v. Everett Vinson & Assoc.*, 264 F. 2d 282, 285 (10th Cir. 1959).

32. While the Eighth Circuit reversed the district court insofar as it allowed a deduction as a business expense, it adopted the district court's opinion on the question of interest. *M.F.A. Central Cooperative v. Bookwalter*, F. 2d (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970].

33. 26 U.S.C. § 162(a).

34. See note 30 *supra*.

ative. . . . The only reason it was purchased was because M.F.A. Central wanted to borrow money from the St. Louis Bank for Cooperatives and the agreement to purchase Class C stock was imposed as a condition of the loan. It is impossible to separate the loan from the purchase of the stock. One was the motivation for the other.³⁵

The district court in *M.F.A.* also considered the loan agreement as significant evidence that the parties understood the obligations to purchase the Class C stock to be apart from the interest requirements. We do not feel that the attitude of the parties is controlling. We agree with the Court of Claims in *Penn Yan* that a current deduction was proper and that the appropriate deduction lies under § 163(a).³⁶ As that court noted this is more logical than the § 162(a) treatment initially given the expenses by the district court in *M.F.A.*, "particularly because the amount of such stock required to be purchased by law and by the loan agreements involved was measured by a percentage of the interest payable on plaintiff's outstanding loan obligations to the bank issuing the stock."³⁷

Accordingly, the judgment of the district court is **AFFIRMED.**

35. 286 F. Supp. at 961.

36. The quid pro quo for taxpayer's present deduction for an interest expense will arise when and if the Class C shares are redeemed. In that event taxpayers must take \$99 into ordinary income. J. Chommie, Federal Income Tax § 17 at 33 (1968); 1 J. Mertens, Federal Income Tax § 7.34 et seq. (1969).

37. 417 F. 2d at 1382.

GODBOLD, Circuit Judge, dissenting:

The majority opinion is a demonstration of what one of the few authorities on the law of cooperatives has counselled against:

The entire field of cooperative corporation law is so relatively new, the basic principles of the cooperative plan are so fundamentally different from those of corporations for profit, and the temporary or interim character of the capital required for proper functioning of a cooperative is so different from the permanent share capital of other business corporations, that even well established concepts in the field of business corporation law cannot safely be applied to cooperative corporations without careful understanding of the reasons underlying those principles and the applicability or inapplicability of those reasons to cooperatives. The fable of the three blind men's impressions of an elephant holds a pointed moral for judges and lawyers approaching the problems of cooperative corporation law and, particularly, the problems of financial structure and operation of cooperatives. Revolving capital cannot be assumed to result from the creation of either an exclusively debtor-creditor relationship or an exclusively corporation-shareholder relationship. Rather it involves a blending of certain elements of both, and frequently something new has been added as well. The resultant product is *sui generis*. In the long run, the public interest will best be served by thorough, patient, and understanding comprehension of what participants in a cooperative enterprise are trying to achieve, rather than by unwarranted assumption that new legal relationships arising from cooperative business transactions and organizations must be neatly and quickly, albeit somewhat forcibly, classified according to pre-existing legal concepts developed under different conditions for different purposes in different kinds of transactions and organizations.

Nieman, *Revolving Capital in Stock Cooperative Corporations*, 13 *Law and Contemporary Problems* 393 at 402 (1948).

The taxpayers are incorporated farmers' cooperatives. In issue is the tax treatment of amounts which they have paid for Class C stock which they hold of the New Orleans Bank for Cooperatives, an incorporated stock cooperative of which they are members and from whom they borrow.¹ The taxpayers say on the one hand that the amounts were not paid for a capital asset, which under 26 U.S.C. (1964 ed.) § 1221 is "property held by the taxpayer" (with designated exceptions none of which is contended to be applicable). They say that in truth all or substantially all of the amounts paid, though cast in the form of the purchase price of capital stock, really were amounts which they had contracted to pay for the use of borrowed money and therefore were interest.² As probative of both of these contentions their underlying argument is that the Class C stock lacks many of the usual characteristics of stock and that it has only nominal value. The government contends the stock is a capital asset, and, recognizing that it may not have fair market value in the usual sense of a willing buyer and a willing seller, says it has intrinsic value.

Once one grasps the function of this particular stock in an institution organized by the Congress as a cooperative³ it is seen that the stock is a capital asset, "property held by the taxpayer," although it does not have the usual

1. The purchases were made by Coastal between 1958 and 1963 in the total amount of \$211,799.68, and by Mississippi Chemical between 1961 and 1963 in the total amount of \$55,113.19. Tax refunds ordered by the District Court are \$265,044.35 to Coastal and \$85,298.51 to Mississippi Chemical.

2. *E.g. Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 76 L.Ed. 484 (1932).

3. Under a charter issued by the Farm Credit Administration.

characteristics of stock in a commercial enterprise organized under general corporation laws. Once that is seen—if not before—the contention that the payments for Class C stock are interest falls.

The Eighth Circuit, in *M.F.A. Central Cooperative v. Bookwalter*, F.2d [8th Cir., No. 19,527-531, June 8, 1970], has reached the same conclusion which I reach. That court held that the required quarterly investments in Class C stock were payments for capital assets. It affirmed the holding of the District Court⁴ that the payments were not interest, and reversed the holding that they were ordinary and necessary business expenses. In so doing it considered *Penn Yan Agway Cooperative v. United States*, 417 F.2d 1372 (Ct. Cl. 1969) and the District Court opinion in the present case and would not follow them.⁵

1.

Central to this case is the fact that the New Orleans Bank for Cooperatives is itself a cooperative. "A cooperative is an association which furnishes an economic service without entrepreneur profit and which is owned and controlled on a substantially equal basis by those for whom the association is rendering service. . . . '[E]ntrepreneur profit' . . . really represents the antithesis of the benefits normally ascribable to cooperatives. 'Entrepreneur profit' is used in the true economic sense of a return for the speculative or risk element in an enterprise. In a cooperative, all the members assume, in a broad sense, the economic risk, and they contemplate no return for the undertaking of the risk." Packel, *The Law of Cooperatives*, § 1, pp. 2-3 (3d ed.).

4. *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo. 1968).

5. *Penn Yan* held that the purchase price of Class C stock was interest to the extent that it exceeded \$6.60 per share, which the taxpayer conceded was its value.

"The primary objective of an ordinary cooperative is not charitable. . . . In the normal case . . . the cooperative is designed to further the economic interest or welfare of its members. Economic welfare does not merely refer to financial savings or increased monetary returns. It cuts much deeper and takes into consideration basic aspects of economic life. Quality of product, decency of service, ownership, control and satisfaction of self-help are important benefits of cooperatives and sometimes are even more important than the direct financial benefits." *Id.* at pp. 6-7. Among the normal attributes of a cooperative are:

- (3) transfer of ownership interests is prohibited or limited;
- (4) capital investment receives either no return or a limited return;
- (5) economic benefits pass to the members on a substantially equal basis or on the basis of their patronage of the association;

Id. at 3.

Justice Brandeis pointed out in his dissent in *Frost v. Corporation Commission*, 278 U.S. 515, 536, 73 L.Ed. 483, 495 (1929) that farm cooperatives seek, in addition to the immediate and direct financial advantage of members, a type of economic democracy as well in which there is equitable assumption of responsibilities and equitable distribution of benefits, and that in addition to financial benefits they promote and effect cooperation among farmers. These objectives, coupled with that of economic strength springing from the combination in a single institution of the combined effort and contributions of all, is important in grasping the relationship between the appellant cooperatives and the cooperative financial institution from which they borrow.

As Professor Nieman points out, the capital of a co-operative, insofar as permanence or impermanence of shares of stock or other units of capital is concerned, is essentially different from the capital of other business corporations.⁶ The commercial shareholder does not anticipate his contribution to capital will be returned to him until dissolution. Prior to dissolution he can recover his contribution by selling his shares to another.

A cooperative's capital, however, more often represents essentially a loan or temporary contribution by its patrons to finance certain economic services for them. The patron-member or patron-shareholder expects that the capital which he contributes will be returned to him prior to dissolution, but not until his own and other patrons' subsequent contributions to capital render his earlier contribution unnecessary to finance the cooperative's facilities and operations. He does not expect to wait until dissolution, and he knows that his shares are not readily salable. He looks to the cooperative to return his capital contributions to him if, and as soon as, it can do so.

Nieman, *supra*, at 393-94. This concept is a formalization of early, informal cooperative arrangements.⁷ As cooper-

6. Nieman, *supra*, at 393.

7. "When more than a century ago, a group of Ohio farmers joined together to ship their cattle to market at Pittsburgh, each of them presumably furnished his share of the cattle, wagons, and equipment which were the capital for the expedition; and each participant's capital was returned to him upon the completion of the project. The horses, wagons, machinery, and labor required for barn raisings or threshing were furnished by the participants, and were returned to them after each job or threshing season. Each participant ceased to provide such capital, and capital previously furnished was returned to him; when he ceased farming and, thus, no longer had need for the barn-raising or threshing services and equipment of his neighbors. In such informal, co-operative enterprises, the temporary nature of the capital employed was plain."

Id. at 394.

atives became more permanent and more continuous in their operations the patron who temporarily put his capital at the service of the group, footnote 7, *supra*, no longer took it home with him when his transaction was over but left it for the use of the continuing activity, though not for its permanent use. But the bedrock principle remained that he received no return or a limited return on his investment in capital.

Most of the formalized early cooperatives were corporations, which organized and structured their capital under the general corporation laws, the only laws available, though unrelated to the particular capital requirements of the cooperative. *Id.* at 393 and 395. "There ever since has been a trial-and-error effort to develop for cooperatives a kind of capital more adequately suited to their peculiar needs and still within the corporate form." *Id.* at 395.⁸

As cooperatives evolved, necessity imposed the creation of a new kind of temporary or interim capital, revolving fund capital.

Provision frequently was made for the return of a member's share of the capital upon the termination of his membership. The risk to the cooperative's financial integrity in the event that a substantial number of members should withdraw and demand the return of their membership capital at the same time required modification of the right to demand a return of membership capital promptly upon termination of membership. Provision was made to suspend the rights and privileges of membership or to retain the member's share of the capital until such time as the cooperative should be financially able to pay it out without

⁸ Today, in most jurisdictions, a cooperative can incorporate either with or without capital stock. Packel, *supra*, § 5(c) at p. 35.

undue prejudice to other members or creditors. The problems incident to the existence of permanent capital, even membership capital repayable upon termination or suspension of membership or reasonably soon thereafter, eventually were met by the creation of a new kind of temporary or interim capital which has now become quite common, although peculiar to cooperatives—that is, revolving-fund capital. *Id.* “The revolving fund plan ‘has been likened to a water wheel, picking up water, using it to create the power that turns the mill machinery, and returning the water to the millstream.’” *Id.* at 396. As the fund of capital becomes adequate it is maintained at that level by continuing to receive each year new contributions to capital by current patrons, and to the extent that new contributions increase the capital above that needed the excess is returned to the patrons who made the earliest contributions. Necessarily there is some awkwardness in the use of shares of stock in a cooperative with revolving capital, but these are tempered by employing different classes of shares. *Id.* at 398-402.

The relationship of the stock cooperative to the member-stockholder who contributes capital is not strictly debtor-creditor, for there is no loan with a maturity date, nor corporation-shareholder in the commercial sense. Though styled corporation-shareholder it is in fact *sui generis*. Nieman, *supra*, at 397 and 402.

3.

It is against this background of recognized principles of cooperative organization and operation that Congress has established a comprehensive farm credit system, which is but a part of a broader program of encouraging the organization and development of effective cooperatives.⁹

9. Packel, *supra*, § 60, p. 275 et seq.

The cornerstone was the Federal Farm Loan Act of 1916,¹⁰ establishing the federal land banks with goals of providing low cost farm credit, promoting farmer ownership of the banks, and establishing and stimulating among farmers cooperative effort.¹¹ Farmers could not borrow directly but were required to form national farm loan associations, which, operating on cooperative principles, would serve as middlemen in securing loans. These cooperative associations were required to purchase stock in the federal land banks in amounts relating to the size of loans (5 per cent of face.)¹²

The Farm Credit Act of 1933¹³ established a much broader structure of farm credit around the original twelve federal land banks. Among the new institutions were the Central Bank for Cooperatives and twelve regional banks for cooperatives which had the specific function of lending to farmers' cooperatives. The initial capital, comparatively nominal, was furnished by the United States in the form of \$110 million, divided between the twelve regional banks and the Central Bank.¹⁴ Each regional bank had but one class of stock. Each borrowing cooperative had to become a member of the regional cooperative bank and a contributor to its capital by purchasing stock (or subscribing to a guaranty fund) in an amount related to the size of his loan. The purchase price of the stock was paid when the loan was closed, either by being deducted from the pro-

10. 39 Stat. 360.

11. S. Rep. No. 144, 64th Cong.; 1st Sess. pp. 2, 4 and 10.

12. The Senate Report said of this requirement:

"At the outset we secure the personal interest of the borrower by requiring him to contribute to the capital of the loan association 5 per cent of the face of his loan. This personal stake makes the . . . borrower a cooperator."

S. Rep. No. 144, *supra*, p. 10.

13. 48 Stat. 257.

14. 2 U.S. Code & Admin. News 1955, p. 2949, at 2950.

ceeds or added to the amount of the loan. However, upon repaying his loan a borrower could withdraw his contribution to capital by demanding redemption of his stock. These withdrawals caused the capital funds remaining in the banks to be insufficient to permit them to operate on a sound basis and to meet the needs of the farmer co-operatives for credit.¹⁵ This is the difficulty which, as Professor Nieman points out, gives rise to revolving fund capital. In 1955 Congress changed the capital structure of the 12 regional banks and the Central Bank for Co-operatives to the revolving fund system.

The Farm Credit Act of 1953 required a study of methods by which to effect increased borrower participation in the management, control, and ultimate ownership of institutions operating under the permanent system of agricultural credit available through the Farm Credit Administration. 2 U.S. Code & Admin. News 1955 at 2947, 2949. The Farm Credit Act of 1955, 69 Stat. 655, which overhauled the entire system of farm credit, was the result of that study. The Senate Committee reported that the House Bill (in no relevant aspect different from the Senate Bill or the Act as passed) "would be a forward step in the goal of having private borrowers owning and managing these credit agencies." *Id.* at 2948.

The House Committee Report described the purpose of the legislation in this way:

The primary purpose of title I of the bill is to provide a plan under which the banks [for cooperatives] would be organized on a truly cooperative basis. Borrowing cooperatives would continually make capital contributions to the system so long as they used its credit service. Each year final net savings (after taxes, dividends, reserves, and surplus requirements)

15. 2 U.S. Code & Admin. News 1955 at 2951; *Penn. Yan, supra*, at 1374.

would be distributed as patronage refunds to borrowing cooperatives in the form of capital stock, all of which capital would remain in the system until all of the capital stock of the United States had been retired. Each year Government capital would be retired in an amount equal to the required stock contributions of and the patronage refunds to the borrowing cooperatives.

Id. at 2951.

The Act established a pure revolving fund capital structure. *Penn Yan, supra*, 417 F. 2d at 1374. It created Classes A, B and C stock, A owned by the government (nonvoting and no dividends); B owned by investors (nonvoting but dividend paying), and C (voting but only one vote to a member, no dividends). 12 U.S.C. § 1134d. Each year, ~~as~~ capital is added through investment in Class C shares by each borrower, and through distribution to borrowers of patronage refunds in the form of Class C shares, an equal amount of Class A shares is retired. Retirement of Class C shares will commence when all Class A stock has been retired, except that as Class C is retired all earlier issued Class B must also be called for retirement.¹⁶ There is no retirement of stock on demand.

In lieu of the one-time purchase of stock previously required of each borrower, the 1955 Act substitutes a system of scheduled purchases of Class C stock. "[E]ach borrower . . . shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum . . . of the amount of interest payable by it to the bank during the calendar quarter. Payment for such stock shall be made quarterly or when the regular interest payments of the borrower are payable." 12 U.S.C. § 1134 d(a) (3). Prior to the 1955 Act required purchases

16. The Class B shares are of nominal importance. In 1963 they constituted only approximately 5 per cent of total stock outstanding in the New Orleans Bank.

were unrelated to interest but keyed to the amount of the loan. Post-1955 purchases are keyed to interest only as a measure of the amount of stock to be purchased. It is obvious that they are keyed to payments of interest for convenience of billing and payment—the borrower pays his scheduled contribution to capital when he makes his interest payment, whether quarterly or otherwise. Amounts due for interest and investment in stock are rendered in the same bill, although separately stated and identified. A borrower who owns Class B stock and does not want to make the required investment in Class C stock by paying cash can convert his Class B to Class C. 12 U.S.C. § 1134 d(a) (3). This has been done by the New Orleans Bank in many instances, always on a dollar-for-dollar basis, \$100 par value of Class C for \$100 par value of Class B.^{16a}

Pre-1955 stock can be converted to Class B or Class C. This has been done on the same basis of dollar for dollar of par value. Some holders of pre-1955 stock have been allowed to apply the full par value thereof against their loans outstanding.

The bank has a statutory lien on the borrower's Class C stock. In cases where it has been exercised against a defaulting borrower, the full par value of the stock has been applied to the loan balance.

In 1956, promptly after the 1955 Act went into effect, the New Orleans Bank established 15 per cent of interest payable during the quarter as the amount of quarterly in-

^{16a.} The necessity of not being hypnotized by the phraseology of the commercial corporation is pointed up by 12 U.S.C. § 1134 d(b). If a borrower is not authorized under the law of the state of its organization to take stock in the bank, it must deposit in the "guaranty fund" of the bank the amount it would have invested in stock. This is the contribution to capital by the cooperative patron in its pure sense, unencumbered by share of stock conceptualism. Patronage refunds to such a borrower are credited against its contributions to the fund. Its deposit is returned to it in the same manner as Class C stock is redeemed.

vestment in stock required of the borrower. It did so pursuant to a policy determination that it hoped to retire all Class A stock by 1976, a 20-year period, and projected the 15 per cent figure as sufficient to achieve that. Retirement has been carried out each year as planned except that the rate of retirement has been better than expected. By 1963 Class A stock had been reduced from the 1956 level of \$7,000,000 to \$4,880,000, as against the projected level for that year of \$5,150,000. In 1966 the Bank estimated informally that all Class A stock would be retired by 1972 or 1973.¹⁷

4.

Purchase of a single Class C share is a prerequisite to eligibility to borrow from the bank. 12 U.S.C. § 1134 d(a) (3). The District Court, the majority in this case and the court in *Penn Yan* viewed the purchase of this single share as conferring upon the purchaser the full spectrum of benefits that could flow to it from stock ownership, so that no additional benefit could accrue by its securing a loan and, as an incident thereof, purchasing additional stock as required. This misses the whole point of the cooperative structure of the banks. The thrust of the Congressional scheme is the promotion of permanent institutions to supply low cost credit to farmers' cooperatives and to foster the creation of additional cooperatives.¹⁸ Ownership of the bank ultimately will be in the cooperatives. They will also participate in management, to the extent of

17. The supplemental brief of the United States quotes from an exhibit in the *M.F.A.* record which states that five of the regional banks have retired all Class A stock and that it is anticipated that all others will accomplish full retirement of the government's investment by 1971.

18. The 1963 report of the New Orleans Bank states that more than half of the cooperatives regularly financed by it are the outgrowth of conferences held by its staff with groups of farmers contemplating the establishment of new cooperatives.

the private sector of the joint government-private management scheme. A purchase of Class C stock does not increase the capital of the bank or its current lending capacity, since Class A stock in a like amount is retired. But each purchase moves the bank toward its ultimate institutional status as a farmer-owned cooperative supplying low cost farm credit to these taxpayers and others like them. The government "primed the pump" by "revolving in" the initial capital of a joint government-private undertaking, the societal values of which it is not the judicial function to question, and from which the government's capital was designed ultimately to be wholly "revolved out." To view the process of replacing government capital by private capital, as do taxpayers, as producing no benefit to anyone except the government which gets its money back, is to misunderstand both the purpose of Congress and the institutional value of the cooperative bank to the cooperatives which will own it and borrow from it.¹⁹

There are institutional values other than that of continued availability of low cost credit. There is the inherent cooperative concept that it is beneficial to channel into a single integrated effort the assets and needs of the group of patrons. There is the benefit of simple economic power, through ultimate substantial ownership of the es-

19. The benefit to these taxpayers, of the New Orleans Bank as a source of low cost credit, is quickly seen by a look at the years here in question. Their purchases of Class C stock for these years were, in round figures: Coastal (1958-63)—\$11,700; \$33,900; \$47,100; \$41,700; \$35,000; and \$42,100. Mississippi (1961-63)—\$18,900; \$16,800; and \$19,300. Each purchase represents 15 percent of the interest paid for the year. Interest usually was between 4 and 5 percent. A simple calculation reveals the massive extent of the loans which they were enjoying.

From its organization through fiscal 1963 the New Orleans Bank made loans to its limited class of borrowers in its region (Louisiana, Mississippi and Alabama) of more than 618 million.

established, fully capitalized, staffed, and accepted financial institution.^{19a}

Other benefits are perhaps more easily perceived because in the more conventional garb of dollars. As borrowers, taxpayers qualify for patronage refunds, distributed to them annually in proportion—as in all co-operatives—to their use of the services offered, thus in this instance measured by interest paid. In 1958-63 Coastal received patronage refunds in Class C stock of \$289,309.81. In 1961-63 Mississippi received \$81,272.57. Together these are 14 per cent of all Class C stock (purchases and refunds) outstanding at the end of fiscal 1963. When their purchases of Class C stock for those years are added, it is revealed that together the taxpayers owned 24 per cent of the outstanding Class C stock.

Also each bank allocates on its books each year to each patron, in proportion to interest paid by the patron, a portion of the amount by which the bank's contingency reserves exceed its needs.²⁰ For the same years as above, Coastal was allocated from surplus \$127,748.62, Mississippi \$35,771.48. This "allocated surplus" eventually is distributed in the form of Class C shares.²¹ The patronage refunds and the allocated surplus are not a return of the borrower's contributed capital but distributions of earnings, not presently convertible to cash but in due

19a. Also it should be noted that the major source of loan funds for each bank is not its capital but funds which it obtains by borrowing from the Central Bank and the federal intermediate credit banks and by sale of debentures in cooperation with other regional banks. This access to low cost funds, and government-assisted credit, continues after Class A stock is retired.

20. Included therein are like distributions which the regional bank receives from the Central Bank for cooperatives.

21. The separate increments of value represented by the Class C stock (purchased and patronage refunds) and the allocated surplus are pointed out in *Columbia Bank for Cooperatives v. Lee*, 368 F.2d 934 (4th Cir. 1966).

course "revolved out" of the cooperative capital into cash to the borrower.

These benefits are measured by the borrower's use of services. But he does not qualify for them by the act alone of borrowing, only by borrowing plus contributing to capital. Congress could have chosen other approaches. A large contribution to capital to become eligible for service was a possibility, but this would be inconsistent with the cooperative concept of nominal financial outlay to become a patron (a small membership fee for the nonstock cooperative, a small purchase of stock for the stock cooperative), with the real and substantial contribution to capital made in proportion to use of services. It would be inconsistent with the aim of fostering organization and growth of fledgling cooperatives. Congress could have required a large one-shot contribution when the loan is made, but it had discovered the disadvantages of this before 1955. It could have provided for adding to capital by higher interest rates carried forward into earned surplus, but this would be inconsistent with its purposes of offering low rates and at the same time shifting from government to private ownership through the normal revolutions of revolving fund capital.

5.

The *sui generis* stock of an incorporated cooperative need not have the same characteristics as ordinary commercial stock to be a capital asset. But the differences loom so large in the minds of the plaintiffs, of the District Court²² and the majority in this court that brief comment is appropriate.

22. The District Court, after emphasizing the differences, concluded that the stock "does not enjoy the usual attributes of shares of stock but are mere bookkeeping entries or devices." The District Court made no references to the peculiarities of cooperative financing. In fact its opinion does not even reveal that the New Orleans Bank is a cooperative.

No Class C stock certificates are issued. A form for the certificates has been approved by the Farm Credit Administration, but the Board of Directors of the New Orleans Bank exercised the discretion given them by the bylaws not to issue certificates. The Bank reflects on its stock ledger the amount of each type of Class C stock owned and at the end of each fiscal year notifies each owner of the amount owned at the beginning and end of the year.²³

The stock has no dividend and no growth potential. This is normal for a cooperative.

Only the first share of Class C stock carries a voting right. "One person one vote" is a basic cooperative principle, which gives recognition to the concept of an economic democracy. Packel, *supra*, at 138-40.²⁴

Class C shareholders will not enjoy sole control of the bank in the commercial sense even when all Class A stock is retired since they will not elect all directors of the joint board which administers it and other farm credit agencies of the region. This makes the stock different from some commercial stock²⁵ but no less a capital asset.

23. This system of recording stock ownership without issuing certificates is no surprise to any holder of shares of almost any one of the major mutual funds which employ the same method for shareholders authorizing automatic reinvestment of dividends and which, like the New Orleans Bank, notify the shareholder periodically of how many new shares he has acquired.

A certificate of stock is not the stock itself but only evidence of ownership. The rights and duties between corporation and stockholder exist apart from the certificate. 11 Fletcher, Corporations, § 5092 (Perm. ed.).

24. The principle is carried forward into the Capper-Volstead Act under which a cooperative marketing association, if it wishes to enjoy immunity from the Sherman Act, must not allow a member more than one vote regardless of how much stock he owns. 7 U.S.C. §§ 291-292.

25. Commercial preferred stock often is nonvoting, and nonvoting common of many companies is traded daily on the stock exchanges.

The stock is not transferable except to other cooperatives and with the consent of the Bank.²⁶ This is usual in a cooperative. Packel, *supra*, pp. 3, 127. It is essential to keep out of the membership persons with interests antagonistic to the cooperative and is an effective means to keep patrons from transferring their interests at a profit. *Id.* at 127-128 and cases there cited.

6.

The majority center on, and repeatedly employ, the phrase "interest override," and even characterize the requirements of the statute in those terms. The term nowhere appears in the statute, the Congressional history, the loan agreements, or the quarterly bills sent taxpayers showing separately interest, principal and "C stock subscription." The President of the New Orleans Bank explained that the term had grown up in that regional bank and in turn had been picked up by its borrowers.

Class C stock purchased under the required investment provisions is shown in the stock ledger separate from that issued as patronage dividends, and under the heading "Investment in C Stock (Interest Override)." The President defined "interest override" as "the amount we require our borrowers to pay over and above interest for the purchase of C stock."

The promissory notes signed by taxpayers provide for interest. Each separate loan agreement provides:

Stock Purchase: The association shall invest quarterly in class C stock of the bank at its fair book value, not exceeding par, an amount equal to 15 per

26. There have been a few approved transfers incident to liquidation, merger or accommodation between cooperatives.

But compare *Columbia Bank for Cooperatives v. Lee*, 308 F.2d 934 (4th Cir. 1966), stating that once issued Class C stock is transferable to any person.

cent of the amount of interest payable by the association to the bank on said loans for said calendar quarter or part thereof. The association shall pay for said class C stock on the date interest is due and payable. . . .

7.

The plainly erroneous rule applied to the finding of the District Court that the Class C stock has only nominal value, may not be the basis of an affirmance. What has been said makes clear that the stock has, as the Eighth Circuit concluded in *MFA*, an intrinsic value. Also it is apparent that the District Court's finding was based on the erroneous basis of comparing the stock, characteristic by characteristic, with that of the usual commercial corporation and totally overlooking its value as a capital contribution to a cooperative under the plan of the Congress.

On the issue of value, in *Columbia Bank for Cooperatives v. Lee*, 368 F. 2d 934 (4th Cir. 1966), a bankrupt cooperative owned Class C stock of the Columbia regional bank with a par value (in round figures) of \$54,200, Class B stock with a par value of \$45,800, and there had been allocated to the bankrupt surplus of \$13,000, total \$113,000. The referee ordered the bank to allow a setoff of this \$113,000 against the cooperative's indebtedness to it of \$162,000, and the District Court affirmed.²⁷ Another cooperative had offered to buy the stock for \$50,000, which was 45 per. cent of its par value and allocated surplus. The Fourth Circuit held that the bank was not required to offset at par value and remanded for valuation by the referee. It declined to accept the single offer of \$50,000 as a reasonable reflection of true value and noted, "However thin the general market for these shares may be, the

27. The New Orleans Bank in many instances has made just such a full offset without legal proceedings.

continuing stream of borrowers from the bank provides it with a ready market." 368 F. 2d at 940.²⁸ The Columbia Bank projected retirement of all Class A stock by 1967. New Orleans Bank stock may be worth less than 45 cents on the dollar because of the difference between projected 1967 retirement of Class A and projected 1972-1973 retirement. But the discount is not to \$1.00 per share or less. In the present case an expert familiar with cooperative financing presented a full and careful analysis of Class C stock of each year separately and assigned values ascending from \$3.42 per share for 1958 Class C stock to \$38.65 per share for that of 1963.

- 8.

My brothers have, in Professor Neiman's terms, felt the leg of the elephant and concluded that the beast is interest. A look at the concept of cooperatives, the legislative history, the expressed intent of Congress, the language of the statute, the books and records of the parties and the loan agreements signed by the taxpayers, reveals that it is an elephant after all. I would join with the Eighth Circuit and would reverse.

28. On remand (not officially reported) no valuation by the referee was necessary. The parties agreed that the trustee would receive a credit in the amount of the value of bankrupt's stock plus allocated surplus, a total of \$112,694.97, and the trustee agreed to pay the bank cash of \$49,305.03, which was the balance of the bank's claim.

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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1082

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (R. 342-346)¹ is not reported. The majority and dissenting opinions of the court of appeals (R. 347-373) are reported at 431 F. 2d 1320.

JURISDICTION

The judgment of the court of appeals (R. 374) was entered on September 14, 1970. The petition for a writ of certiorari was filed on December 10, 1970, and certiorari was granted on February 22, 1971 (R. 375). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

¹ "R." references are to the separately bound record appendix.

QUESTION PRESENTED

Whether the amounts paid by the respondent cooperatives for purchases of the Class C stock of the New Orleans Bank for Cooperatives, made in connection with loans secured from that Bank, are nondeductible capital outlays rather than deductible interest or ordinary and necessary business expenses.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Income Tax (1954 Code) are set forth in Appendix A, *infra*, pp. 45-46. The pertinent provisions of the Farm Credit Acts, and amendments thereto, are set forth in Appendix B, *infra*, pp. 47-67.

STATEMENT

Respondents, cooperative associations,² are members of, and borrowers from, the New Orleans Bank for Cooperatives (R. 93, 111). They filed federal income tax returns for the years in suit³ on the basis of a fiscal year ending June 30, using the accrual method of accounting (R. 93, 112, 349-350).

The New Orleans Bank for Cooperatives is one of twelve regional banks for cooperatives which, together with the Central Bank for Cooperatives in Washington, D.C., were originally chartered in 1933.⁴ These

² As defined in Section 15(a) of the Agricultural Marketing Act, c. 24, 46 Stat. 11, Appendix B, *infra*, p. 47.

³ In the case of Mississippi Chemical Corporation, the fiscal years 1961 through 1963; in the case of Coastal Chemical Corporation, the fiscal years 1958 through 1963.

⁴ Section 2, Farm Credit Act of 1933, c. 98, 48 Stat. 257, Appendix B, *infra*, p. 48. Unless otherwise specified, references to farm cooperative legislation are to this Act, as amended.

banks are themselves cooperatives and are structured in accordance with the provisions of the Farm Credit Act of 1955, c. 785, 69 Stat. 655. Their purpose is to furnish farmer cooperatives a specialized and readily available source of financial services, including credit, at the lowest cost consistent with sound business practices (Ex. 18-B, pp. 1-2). They are capitalized under a mechanism adopted by statute whereby the initial capital is contributed by the government but is thereafter gradually replaced by capital belonging to the member borrowers. S. Rep. No. 1201, 84th Cong., 1st Sess., p. 1. The goal of this statutory mechanism is the establishment of permanent cooperative banks, with increasing borrower participation in management and control, and, ultimately, complete borrower ownership, of the banks. Sec. 2, Farm Credit Act of 1953, Appendix B, *infra*, pp. 62-63; S. Rep. No. 1201, *supra*, pp. 5-6.

The banks are authorized to issue three classes of stock—Class A, Class B and Class C—each with a par value of \$100 per share. Section 42(a), Farm Credit Act of 1933, Appendix B, *infra*, pp. 53-57. Class A stock represents the government's original capital contribution to each bank. Under the Act, it is nonvoting, pays no dividends and is to be retired at par according to a method which depends upon the amount of Class C stock purchased by cooperatives such as the respondents, and upon the bank's net savings. Section 42(a)(1). Class B stock is intended for sale to investors in the public at large as well as to farmer cooperatives. S. Rep. No. 1201, *supra*, p. 10. It is issued at par, is nonvoting and

may pay noncumulative dividends not to exceed four percent per year. After all Class A stock has been retired, Class B stock may be retired at par, the oldest Class B stock to be retired first, Section 42(a)(2). Class C stock is the voting, common stock of the banks. S. Rep. No. 1201, *supra*, p. 10. Issued at par (\$100), it may normally be purchased only by farmer cooperatives. Section 42(a)(3).

There are four ways in which farmer cooperatives may acquire Class C stock.

First, each must purchase at least one share of Class C stock in order to be a member and to be eligible to borrow. Section 42(a)(3).

Second, each borrower must invest quarterly in Class C stock an amount equal to not less than 10 nor more than 25 percent of the amount of interest which it pays to the bank on its loans during the calendar quarter. Section 42(a)(3). The rate for the New Orleans Bank during the years in issue was 15 percent (R. 94, 112).

Third, as of the end of the fiscal year each borrower receives additional Class C stock as "patronage refunds" or "patronage dividends." Such stock is payable out of each bank's net savings, after deduction of operating and certain other expenses, in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year. Section 42(a)(3).

Fourth, in addition to receiving Class C stock as patronage dividends, borrowers receive as of the end of each fiscal year an "allocated surplus" credit which

also is payable out of each bank's net savings. Like patronage dividends, a bank's allocated surplus is credited to each member in accordance with the proportion that the interest earned on its loans bears to the interest earned on the loans of all members during the fiscal year. Farm Credit Administration Regulations, Section 70.162,⁵ Appendix B, *infra*, pp. 65-66. When the surplus account reaches 25 percent of the total outstanding capital stock of the bank, the excess may be distributed to members in the form of Class C stock, with members with the oldest allocated surplus credits receiving the first stock. (Stip. Ex. 17, pp. 48-49.)

Only the tax treatment of the additional Class C stock acquired in connection with loans—that is, the stock referred to in paragraph “Second,” above—is here in dispute.

A shareholder of Class C stock is entitled to one vote, regardless of the number of shares it owns. The shareholder may vote for nominees to the Federal Farm Credit Board⁶ and, during the years in issue, for one of the directors of the local bank. Section 5 (d), (e) and (f), Farm Credit Act of 1937, Appendix B, *infra*, pp. 59-62; Section 4(a), Farm Credit Act of 1953, Appendix B, *infra*, pp. 63-64. If a shareholder's account with the bank is dormant for a period

⁵ References herein are to the Farm Credit Administration Regulations as they appeared in the January 1, 1966 edition of 6 C.F.R. These regulations are now codified in 12 C.F.R., Parts 670-673.

⁶ The Federal Farm Credit Board acts through the Farm Credit Administration, which in turn supervises the Banks for Cooperatives (R. 168, 181).

of two years, the shareholder's voting privileges are suspended. Section 42(a)(3).

Class C stock is redeemable at full par value, but not until the stock prior to it—all Class A stock, earlier issued Class B stock, Class B stock issued during the same fiscal year, and earlier issued Class C stock—has been redeemed.⁷ Section 42(a)(3). But where the borrower-Class C stockholder is in bankruptcy or receivership, has ceased operations or is unable to pay its debts to the bank, its Class C stock, upon which the bank has a lien, may be redeemed immediately at full par value (R. 45-46; Stip. Ex. 17, p. 44). See Sections 36(d), 42(c). While Class C stock is not freely transferable, it may be transferred to other cooperatives with the consent of the bank (Ex. 17, pp. A69-A70). Such approved transfers have occurred incident to liquidations, mergers or accommodations between cooperatives (R. 107, 275-291).

Although a form for Class C stock certificates has been approved by the Farm Credit Administration, the Board of Directors of the New Orleans Bank exercised the discretion given it in the bylaws not to issue certificates. Instead, the bank reflects in its stock ledger the number of shares of Class C stock owned by each cooperative association and the manner in

⁷ The Farm Credit Administration advises that, for purposes of retirement, Class C stock acquired through conversion of allocated surplus is deemed to have been issued at the time the surplus allocation was made.

which such stock was acquired—whether by purchase, by patronage dividends, or through allocated surplus conversions. Shortly after the end of each fiscal year, the bank notifies each owner of the number of shares owned at the beginning and end of that year. (R. 96, 114-115; Stip. Ex. 17, p. 45.)

Since the enactment of the Farm Credit Act of 1955, substantially all ~~the~~ capital represented by the Class C stock has been applied by the banks to revolving out and retiring the Class A stock. See Section 42(a)(1). The Farm Credit Administration advises that the retirement of all the Class A stock in all the banks was completed as of December 31, 1968, the date on which the New Orleans Bank retired its last Class A stock. The banks have since redeemed the earliest purchased Class C stock. According to Farm Credit Administration records, the first series of Class C stock of the New Orleans Bank, issued as of the close of the fiscal year ended June 30, 1956, was retired 14 years later, shortly after the close of the fiscal year ended June 30, 1970.

Respondents each owned one eligibility share of Class C stock in the New Orleans Bank, the cost of which they capitalized as an investment (R. 97, 116). During the taxable years here in issue, they purchased Class C stock in connection with their loans from the New Orleans Bank, and received patronage dividends and allocated surplus credits in the amounts shown in

the margin.* On their federal income tax returns for these years, respondents deducted the stated interest payable on the loans. They also deducted as interest \$99 out of each \$100 paid for Class C stock, treating the \$1 balance as the cost of acquiring an asset. The Commissioner allowed the deductions for the stated interest, but disallowed the deductions representing the cost of the Class C stock on the ground that purchases of such stock constituted nondeductible capital investments. Respondents paid the resulting deficiencies and in due course brought these consolidated actions for refund. (R. 5-15, 55-70.)

At trial in the district court, respondents' witnesses testified (R. 245-247, 265-266) that the Class C stock in question was in essence valueless, because it could be neither sold nor transferred except in unusual circumstances, and because it gave the owner only the right to recover the par value of the shares at some indefinite future time. Since the present value of such a right was nominal, and since the stock was purchased as a condition to continued borrowing from the bank, the court concluded that its cost was, in substance, merely additional interest within the mean-

Year	Class C stock purchased	Patronage dividends	Allocated surplus
Mississippi Chemical Corporation (R. 117-118; Stip. Ex. 31):			
1961.....	\$18,940.09	\$27,489.40	\$12,202.89
1962.....	16,865.75	25,152.83	11,298.75
1963.....	19,307.35	28,888.10	12,329.84
Coastal Chemical Corporation (R. 98-99, 123-124):			
1958.....	\$11,788.19	\$14,345.04	\$6,781.42
1959.....	33,956.20	47,361.32	20,947.65
1960.....	47,119.23	51,689.89	22,845.53
1961.....	41,712.88	60,541.82	26,875.13
1962.....	35,072.16	52,305.05	23,370.87
1963.....	42,151.02	63,067.29	26,918.00

ing of Section 163(a) of the Internal Revenue Code (Appendix A, *infra*, p. 45). (R. 342-346.). On appeal a divided Fifth Circuit affirmed (R. 347-373).⁹ Neither the district court nor the court of appeals decided whether, as respondents alternatively claimed, the cost of the Class C stock was deductible as an ordinary and necessary business expense under Section 162(a) (Appendix A, *infra*, p. 45).¹⁰

SUMMARY OF ARGUMENT

A

The Internal Revenue Code allows a current deduction for interest expense and for ordinary and necessary business expenses. On the other hand, the cost of acquiring an asset—an item of value—having a useful life extending substantially beyond the close of the taxable year is not currently deductible. The question here is whether respondents' required outlays for Class C stock constituted interest or business expenses, or whether the Class C stock is an item of continuing value in respondents' hands, so that its cost must be capitalized.

⁹ Respondents reported \$1 per share of the patronage refunds they received as a reduction of interest expense, but did not include in income the remaining \$99 of par value of each share. In the district court, the government contended that the entire par value of each patronage refund share constituted income upon receipt. The district court decided this issue adversely to the government, and the government did not appeal.

¹⁰ The district court did not mention the ordinary and necessary expense question. The court of appeals referred to Section 162(a) (R. 357-358), but found that treatment of the cost as interest was "more logical" (R. 358) and did not definitively resolve the issue.

B

The Farm Credit Act of 1955 and the legislative history of that Act, as well as earlier farm cooperative legislation, argue strongly in favor of the latter conclusion. The architects of the Banks for Cooperatives system, both in and out of Congress, intended member stock purchases to be the mechanism by which farmer cooperatives would obtain actual ownership and increasing control of the banks. Such ownership and control have been considered a prime necessity by these leaders in their effort to furnish farmers the opportunity to achieve their economic goals. This concept is the very antithesis of respondents' claim that such purchases are merely another short-term expense of doing business from which they derive no benefits extending beyond the taxable year of purchase.

Moreover, the terminology Congress used in the 1955 Act and in the legislative history also shows that the payments in question are not to be considered interest or another type of expense. Congress provided for the issuance of "stock" and referred to the payments as "capital contributions" and "investments." Each of these terms describes an item generally recognized as having continuing value. While the terminology used in a non-tax statute does not necessarily control tax consequences, we submit that the clear congressional intention reflected by that terminology should be given effect in determining the tax treatment of required Class C stock purchases.

Despite the language of the 1955 Act and the legislative history, the majority below concluded that respondents did not acquire an item of continuing value when they made required Class C stock purchases, but merely paid additional interest over and above the nominal value of the stock, \$1 per share. Emphasizing that the substance rather than the form of the stock payments must control, the court held that purchased Class C stock bore no return and, since it could not easily be transferred, entitled the owner only to recover its original payment at an indefinite future time.

Neither the fact that respondents were required to invest in Class C stock in connection with their loans, nor the limitations on transferability of the stock, could convert its cost into a deductible expense if it otherwise would qualify as an income-producing asset providing benefits in future years. Our position is that under the court's own substance-over-form analysis, the purchased Class C stock must be considered such an asset.

By making the required stock purchases, in addition to paying interest on its loans, respondents became entitled to receive in the future not only a return of the purchase price, but also a portion of the bank's profits for the year in which the stock was purchased. Originally distributed in the form of patronage dividends and allocated surplus credits, this return is ultimately paid in cash. In concluding that respondents earned no return on their investment, the court of appeals erroneously looked at the purchased Class

C stock in isolation, instead of considering the reality of the total amount that respondents will receive when a year's purchased stock, the patronage dividend stock of the same year, and the related allocated surplus credit stock is redeemed.

In addition to the return earned by Class C stock, the stock provides its owners with intangible benefits extending substantially beyond the close of the taxable year in which the stock is purchased. These benefits include the opportunity to obtain loans at favorable rates, a voice in the management of the bank and various financial services, all of which led the dissenting judge below to conclude that the Class C stock purchased had intrinsic value.

The fact that the payments for Class C stock can be viewed as payments for services does not make the stock any less an item of continuing value than the stock of an ordinary corporation. Nor does the different way in which a cooperative divides its profits mean that cooperative stock is not such an item. Contributions to the capital of an ordinary corporation have consistently been held nondeductible. Contributions to the capital of a cooperative corporation also should be nondeductible.

D

Although the court of appeals recognized that the Class C stock had the nominal value of \$1 per share assigned to it by respondents, it held that the remaining \$99 of par value per share was deductible. There is no basis in the Code for allowing a loss on the purchase of an asset—even one of nominal value—

unless that loss is realized by a sale or other final transaction. While respondents seek to avoid this rule by claiming interest and business expense deductions, it is settled that in the absence of realization of a loss, the cost of an asset may be recovered only through depreciation or amortization.

E

Not in point here are opinions in usury cases to the effect that a lender's requirement that a borrower purchase property from him at an excessive price, as a condition to making the loan, gives rise to interest to the extent that the price of the property exceeds its fair market value. These cases are inapposite because the price of Class C stock is not excessive; the stock earns a return and also has intrinsic value. Apart from this, the principle of these cases is not unqualified. This Court and the great majority of the state and lower federal courts have held that the stock purchases which building and loan associations (a type of cooperative) have required borrowers to make as a condition to obtaining loans, under a system similar to that used in the instant case, do not constitute additional interest for purposes of the usury laws. The principal caveat attached to such building and loan arrangements, obviously not present here in view of the congressional structuring of the system, is that the stock purchases must not constitute a corrupt agreement to mask usury.

ARGUMENT

CLASS C STOCK PURCHASED BY RESPONDENTS CONSTITUTES AN ASSET WITH A USEFUL LIFE EXTENDING SUBSTANTIALLY BEYOND THE CLOSE OF THE TAXABLE YEAR

A. INTRODUCTION

Section 163(a) of the Internal Revenue Code allows a deduction for "all interest paid or accrued within the taxable year on indebtedness." In *Deputy v. duPont*, 308 U.S. 488, 498, this Court construed the term "interest on indebtedness" to mean "compensation for the use or forbearance of money."

Section 162(a) allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." An expense is "necessary" if it is "appropriate and helpful" in the taxpayer's business. *Welch v. Helvering*, 290 U.S. 111, 113; *Commissioner v. Tellier*, 383 U.S. 687, 689. But this Court held long ago that to be deductible under Section 162(a), an expense must be "ordinary" as well. See *Welch v. Helvering*, *supra* at 113-116. More recently, in the *Tellier* case, the Court explained (383 U.S. at 689-690) that "[t]he principal function of the term 'ordinary' in §162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset."

Although interest, and ordinary and necessary business expenses, are currently deductible, "any expenditure which results in the creation of an asset having a

useful life which extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred." Treasury Regulations on Income Tax (1954 Code), Section 1.461-1(a) (2) (Appendix A, *infra*, pp. 45-46).¹¹ See *Wells-Lee v. Commissioner*, 360 F. 2d 665 (C.A. 8); *Feitelbaum v. Commissioner*, 294 F. 2d 541 (C.A. 7), certiorari denied, 368 U.S. 987; *Darlington-Hartsville Coca-Cola B. Co. v. United States*, 273 F. Supp. 229, 231 (D. S.C.), affirmed, 393 F. 2d 494, 496 (C.A. 4), certiorari denied, 393 U.S. 962. Such an expenditure must be capitalized and recovered through depreciation or amortization, or when gain or loss is realized upon the sale or other disposition of the asset. See *Woodward v. Commissioner*, 397 U.S. 572, 574-575.

While the Code nowhere defines the term "asset" as used in the quoted regulations,¹² the dictionary defines it as "an item of value owned" (Webster's Third New International Dictionary (Unabridged), p. 131), and we do not believe that respondents would dispute that this definition is applicable for present purposes. Since it is clear that respondents owned the Class C stock in question, the issue narrows to whether that stock constitutes an item of continuing value, or whether the benefit from the expenditure made is exhausted in the year of payment, so that the expenditure is simply a current cost of doing business.

¹¹The cited regulation prescribes this rule for accrual basis taxpayers like respondents. The same rule applies to cash basis taxpayers. Treasury Regulations on Income Tax (1954 Code), Section 1.461-1(a) (1).

¹²Section 1221 defines "capital asset."

This issue has engendered a variety of differing views in the lower courts. In *Penn Yan Agway Co-operative, Inc. v. United States*, 417 F. 2d 1372, the Court of Claims, using an analysis similar to that employed by the court below, held that the purchase price of Class C stock in excess of \$6.90 a share constituted deductible interest. In *M.F.A. Central Cooperative v. Bookwalter*, 286 F. Supp. 956 (E.D. Mo.), the district court rejected the interest argument, but held that the entire cost of the stock was deductible as an ordinary and necessary business expense. On appeal, the Eighth Circuit agreed with the conclusion on interest, but reversed on the business expense issue, holding that the cost of the stock was nondeductible in its entirety. 427 F. 2d 1341, petition for a writ of certiorari pending, No. 824, this Term. The Tax Court reached the same conclusion in *Hunter v. Commissioner*, 46 T.C. 477.

B. THE STATUTES GOVERNING THE BANKS FOR COOPERATIVES, TOGETHER WITH THEIR LEGISLATIVE BACKGROUND, SHOW THAT CONGRESS CONSIDERED CLASS C STOCK TO BE AN ITEM OF CAPITAL OWNERSHIP OF CONTINUING VALUE

The system of the Banks for Cooperatives is an outgrowth of the Federal Land Bank System created by the Federal Farm Loan Act of 1916, c. 245, 39 Stat. 360. Federal Land Banks were established in recognition of the farmer's need for capital, his frequent inability to obtain it, and the high rates of interest he was charged. S. Rep. No. 144, 64th Cong., 1st Sess. pp. 1-3; see Stip. Ex. 18A, p. 1. Originally capitalized by the government, the Federal Land Banks were required by the governing statute to revolve out the

government's capital and to replace it with capital furnished by members. This was to be accomplished by requiring a member to purchase stock in a Land Bank Association equal to five percent of the amount of its loan.¹³ Federal Farm Loan Act, *supra*, Section 5, 7, 8; S. Rep. No. 144, *supra*, p. 4; R. 164. The government's capital was completely revolved out by the end of 1947. S. Doc. No. 7, 84th Cong., 1st Sess., p. 4; S. Rep. No. 1201, *supra*, p. 20.

The Farm Credit Act of 1933, c. 98, 48 Stat. 257, supplemented the 1916 Act with a parallel system to supply credit to cooperatives engaged in agricultural production and marketing. S. Rep. No. 124, 73d Cong., 1st Sess., p. 1; H. Rep. No. 171, 73d Cong., 1st Sess., p. 1. Again, the system was grounded in cooperative principles, with an initial supply of government capital to be replaced gradually by the capital of the borrowers themselves. S. Rep. No. 124, *supra*; R. 164. The government's original subscription amounted to \$110 million. S. Doc. No. 7, *supra*, p. 6; S. Rep. No. 1201, *supra*, p. 5. In accordance with the announced goal of cooperative ownership of the banks, Section 43 of the 1933 Act provided that, if a bank's resources permitted, the government's stock should be redeemed. As was the case under the Federal Farm Loan Act, *supra*, Section 35 of the 1933 Act required each cooperative association

¹³ Under the 1916 Act, farmers did not borrow directly from the Federal Land Banks but from national associations which acted as middlemen for securing loans from the banks. Both the banks and the associations operated under cooperative principles. Federal Farm Loan Act, *supra*, Section 7; S. Rep. No. 144, *supra*, pp. 4-5.

which borrowed from the banks to invest an amount equal to five percent of the loan in stock of the banks.

As business of the banks increased, it was found advisable to increase the amount of stock subscribed by the government to a peak of \$178.5 million in 1945. S. Doc. No. 7, *supra*; S. Rep. No. 1201, *supra*. The banks thereafter were subjected to criticism because of the slow rate at which government capital was being replaced. By September, 1954, the government's share of the Cooperative Banks' capital still exceeded \$150 million, while the share held by farmers' cooperative associations stood at less than \$19 million; the banks' earned surplus amounted to approximately \$80 million. S. Doc. No. 7, *supra*. The relatively small capital share of the banks owned by cooperatives was traceable to a provision in Section 35 of the 1933 Farm Credit Act allowing borrower cooperatives, upon payment of their loans, to have their stockholdings retired and cancelled by the Banks (R. 165).

In an effort to accelerate borrower ownership, the Federal Farm Credit Board recommended that new "legislation be enacted which would convert the banks for cooperatives from institutions in which the United States Government holds substantial investments of capital stock into institutions which would become wholly capitalized by their users." S. Doc. No. 7, *supra*, p. 6. Congress thereupon enacted the Farm Credit Act of 1955, c. 785, 69 Stat. 655.

The statute provided for an orderly, mandatory replacement of government-held stock with stock owned by cooperative associations. S. Rep. No. 1201, *supra*, p. 1; S. Doc. No. 7, *supra*, p. 6. Government capital would

be repaid by substituting in its place capital of the members and users of the banks. Senate Hearings Before a Subcommittee of the Committee on Agriculture and Forestry on Farm Credit Act of 1955, 84th Cong., 1st Sess., pp. 51, 110, 111; S. Rep. No. 1201, *supra*. "Borrowing cooperatives would continually make capital contributions to the system so long as they used its credit service. Each year final net savings (after taxes, dividends, reserves, and surplus requirements) would be distributed as patronage refunds to borrowing cooperatives in the form of capital stock, all of which capital would remain in the system until all of the capital stock of the United States had been retired." S. Rep. No. 1201, *supra*, p. 6. After the government's capital had been retired, "capital investments of borrowers would be revolved in accordance with the cooperative principle of retiring first the oldest outstanding stock." S. Doc. No. 7, *supra*, p. 6; see House Hearings Before the Subcommittee on Agriculture on Farm Credit Act of 1955, 84th Cong., 1st Sess., pp. 30-31.

The dual purposes of the 1955 Act thus were to raise private capital to replace the government's capital in the banks,¹⁴ and to accelerate farmer ownership and control of the entire agricultural credit system, of which the Banks for Cooperatives are a significant part. See

¹⁴ The banks have always treated Class C stock as part of their capital. It appears in the usual place for shareholders' capital contributions and is listed under the title "Stockholders' Equity" on their balance sheets (R. 148). It is available to satisfy creditors' claims only after all of the banks' other funds (current earnings, loss reserves and allocated surplus) have been exhausted (R. 267).

R. 164-177; Stip. Ex. 18A, pp. 17-23, 25, 32-33, 36-37.

The latter purpose was explained at the Senate Hearings on the proposed legislation which became the Farm Credit Act of 1955 as follows (Senate Hearings, *supra*, p. 60):

The purpose * * * is to make these institutions fully cooperative and to place full ownership and responsibility for their operations and success in the hands of those eligible to borrow from them. * * * [The] idea is that it is better for farmers to solve the economic problems of American agriculture to the greatest possible extent by means of voluntary cooperative self-help and to reduce correspondingly the need for government programs.

To allow borrowers to treat the costs of Class C stock as interest or another type of current expense would be inconsistent with both these purposes.¹⁵

It seems undeniable, in view of the legislative history of the 1955 Act and the background of the Banks for Cooperatives system, that Congress considered Class C stock to be an investment of capital, an asset with a useful life extending substantially beyond the close of the taxable year, rather than simply an increase in the rate of interest charged on loans to cooperatives, or another type of current expense. If Congress had thought that the banks' income was inadequate, it would have been a simple enough matter

¹⁵ It would also be inconsistent with the banks' own treatment of the Class C stock which they, as members of, and borrowers from, the Central Bank for Cooperatives are required to purchase as a condition of obtaining their loans. See Section 42(a) (3); Stip. Ex. 17, p. 40. The New Orleans Bank has always accounted for such Central Bank Class C stock as an asset on its books (R. 148).

for it to have authorized an increase in the rate of interest charged, or to have imposed another charge on borrowers, when it enacted the 1955 Act. But that is not what Congress did. It chose instead to denominate the additional payments made by borrowers as being for the acquisition of "stock," and referred to the payments as "capital contributions" or "investments." All of these terms connote items commonly considered to be assets having continuing value.

We recognize, of course, that Congress did not prescribe the tax treatment of Class C stock when it enacted the 1955 Act, and that the terminology used in a non-tax statute is not conclusive for tax purposes. But the tax provisions here involved are not divorced from financial reality, but rather generally follow well understood concepts of interest, current expense and capital investment. Furthermore, it is necessary here to determine the tax consequences of what the majority below described as "ambiguous transactions" (R. 356). Under these circumstances, it is entirely fitting to resolve the ambiguities in a manner consistent with Congress' unmistakable intention, even though that intention was expressed in a non-tax context.¹⁶

¹⁶ Although the Banks for Cooperatives were exempt from income tax during the years here in issue, each became subject to tax when it retired all of its Class A stock. Sec. 63, Appendix B, *infra*, pp. 58-59. In consequence, if the stock purchase payments are held to be deductible, and if, as a corollary, the banks are required to report the payments as income, tax will be due on the payments. We are advised by the Farm Credit Administration, based on their study covering the last five years, that the banks will suffer a loss in lending power of approximately \$100 million over a five-year period if tax is imposed on the payments for Class C stock.

C. THE CLASS C STOCK PURCHASED BY RESPONDENTS HAS
CONTINUING VALUE

In holding that the costs in question were deductible, the court below cited a variety of factors which, in its view, required the conclusion that the Class C stock had no practical value in respondents' hands. The most important among these were that the purchases had to be made to obtain and continue loans; that the stock was subject to severe restrictions on transferability and convertibility;¹⁷ and that the stock paid no dividend and had no growth potential.

Neither of the first two factors, whether operating independently or together, can convert a cost that otherwise would be nondeductible into a currently deductible expense. Compare *Commissioner v. Lincoln Savings and Loan Association*, No. 544, this Term, certiorari granted, 400 U.S. 901, on which oral argument was heard on February 23, 1971. Thus, it has been held in a variety of situations that the cost of an item in the nature of an asset having a useful life extending substantially beyond the close of the taxable year may not be deducted, even if the cost is forced upon the taxpayer by law or by economic cir-

¹⁷ The restrictions are not as severe as the court of appeals thought (R. 351). The record shows five transfers of Class C stock from one cooperative to another (R. 107, 275-291), one of which involved a payment of \$12,000 for Class C stock and related allocated surplus credits (R. 280-282). The bank also redeemed Class C stock for full book value on 10 occasions during the years in issue (R. 130, 133, 241; see R. 45-46, 238-239, 248-249; Farm Credit Adm. Regs., Secs. 70.165, 70.165a, Appendix B, *infra*, pp. 66-67). Cf. *Columbia Bank for Cooperatives v. Lee*, 368 F. 2d 934, 936-940 (C.A. 4).

cumstances.¹⁸ And, it is likewise clear that such a cost does not become deductible merely because the asset may not easily be converted into cash or other liquid assets through sale or other disposition.¹⁹ While restrictions on transferability may make a long-lived asset less desirable than it otherwise would be, they do not change its fundamental character.

As for the conclusion below that purchased Class C stock produces no income, our position is that the court was in error, and that such stock in substance provides purchasers with long-term benefits in the form of a return on their investment. Moreover, the stock also has intrinsic value, in that it provides purchasers with a variety of intangible long-term benefits. We turn now to a detailed consideration of the continuing value of Class C stock.

1. *The stock in substance earns a return*

The court below thought (R. 356) that "incisive realism" justified current deductibility of purchased Class C stock because such stock gave its owners only

¹⁸ See, e.g., *Welch v. Helvering*, 290 U.S. 111; *Woodward v. Commissioner*, 397 U.S. 572, 579 n. 8; *Woolrich Woolen Mills v. United States*, 289 F. 2d 444, 448 (C.A. 3); *Falstaff Beer, Inc. v. Commissioner*, 322 F. 2d 744, 745 (C.A. 5); *Teitelbaum v. Commissioner*, 294 F. 2d 541, 544 (C.A. 7), certiorari denied, 368 U.S. 987, and cases cited therein; *Russell Box Co. v. Commissioner*, 208 F. 2d 452, 454, 455 (C.A. 1); *RKO Theatres, Inc. v. United States*, 163 F. Supp. 598 (Ct. Cl.).

¹⁹ See, e.g., *Connecticut Light and Power Co. v. United States*, 368 F. 2d 233, 241-242 (Ct. Cl.); *Robertson v. Steele's Mills*, 172 F. 2d 817 (C.A. 4); *Gauley Mt. Coal Co. v. Commissioner*, 23 F. 2d 574, 578 (C.A. 4); *J.C. Cornillie Co. v. United States*, 298 F. Supp. 887, 896-897 (E.D. Mich.); *Lutz v. Commissioner*, 2 B.T.A. 484.

the right to receive their money back, with no return, at some indefinite future time. It quoted with approval (R. 354) the Court of Claims' remark in *Penn Yan Agway, supra*, 417 F. 2d at 1378, that substance must prevail over form "in the extremely practical field of taxation * * * ." But, in our view, the court failed to apply this standard properly in reaching the conclusion that Class C stock earns no return.

When a borrower cooperative purchases Class C stock, thus fulfilling its obligation under its loan agreement (R. 127), it becomes entitled to share in the distribution of the bank's net savings at the end of the fiscal year. Shortly thereafter, the bank sends each borrower a statement (R. 117, 130) showing not only the Class C stock which it purchased during the year, but also the Class C stock received as a patronage dividend. Surplus allocations are also credited to borrowers at this time (R. 99, 118, 123-124; Stip. Ex. 31).

These distributions of patronage dividends and allocated surplus are not insubstantial. For example, for its fiscal year ended June 30, 1961, Mississippi Chemical Corporation received \$27,489.40 in patronage dividends, and \$12,202.89 in allocated surplus credits (see n. 8, *supra*), while it made stock purchases in that year of \$18,940.09 (*ibid.*). Assuming that the 14-year retirement period for Class C stock continues (see p. 7, *supra*), and leaving aside completely its share of allocated surplus for the year, Mississippi Chemical will receive in cash shortly after the close of fiscal 1975, not only its original investment of \$18,940.09, but an additional \$27,489.40. This represents

an average annual return on its investment of 6.16 percent. If the redemption period were 10 years, the average annual return would be 9.38 percent; if it were as long as 30 years, the return would be 3.03 percent.²⁰

It is no answer to the foregoing analysis to say that the return was not earned on the investment, but was simply a refund of excessive interest charges. In the first place, the patronage dividend is paid out of the bank's entire earnings, not merely the interest it earns on cooperative loans. Second, it is not by the act alone of borrowing that a cooperative qualifies to receive patronage dividends; it must also purchase Class C stock. Indeed, we are advised by the Farm Credit Administration that a non-cooperative borrower which is not required to purchase stock receives no patronage dividend.²¹ Third, and most

²⁰ As we have noted (see n. 16, *supra*), the Banks for Cooperatives became subject to tax when they retired all of their Class A stock (December 31, 1968, in the case of the New Orleans Bank). Sec. 63, *supra*. Under the applicable provisions of the Internal Revenue Code (Sections 1382(b)(1) and 1388(c)(1)), a bank must pay 20 percent of its patronage dividends in cash to prevent taxation to it of the full amount of the patronage dividends distributable. According to information supplied by the Farm Credit Administration, the New Orleans Bank has made the required cash distributions beginning in 1969. This means that respondents now realize an even higher rate of return on their Class C stock payments.

²¹ Although, under the 1955 Act, the Banks for Cooperatives are empowered to require non-cooperative borrowers to purchase Class C stock (see H. Rep. No. 863, 84th Cong., 1st Sess., p. 10), the Farm Credit Administration advises that they have not exercised this authority. A non-cooperative may become indebted to a Bank for Cooperatives if, for example, it purchases property subject to a loan made by the bank.

important, we are dealing here with matters of substance and form. Although the governing statute provides that patronage dividends and allocated surplus are to be distributed to farmer cooperatives in accordance with the ratio of the interest paid by each cooperative to the interest paid by all, the result would be the same if the statute had provided that the dividends and allocated surplus would be distributed in accordance with the proportion of each cooperative's required Class C stock purchases to total Class C stock purchases. This is so because such purchases themselves are made in accordance with the ratio of the interest paid by each cooperative to the interest paid by all.

If the statute had provided for distributions in accordance with the ratio of required Class C stock purchases, it would be clear that the Class C stock was an income-producing asset which, if held to maturity, would produce significant benefits over and above a mere return of capital. Since the court below saw fit on substance-over-form principles not to be bound by the terminology used by Congress in the 1955 Act, it likewise should not have felt itself bound to assume that Class C stock earns no return merely because no return was expressly stated.²²

²² *Amicus* contended below (see R. 350-351 n. 6) that the government's failure to appeal from the district court's decision that patronage dividends are not income when received to the extent of their par value (see n. 9, *supra*) is inconsistent with the government's position that the cost of purchased Class C stock is nondeductible. But the question when a return is to be taken into income by accrual basis taxpayers like respondents turns on when all events have occurred to fix the taxpayers' right to the income. Treasury Regulations on Income Tax (1954

To be sure, the type of return earned on Class C stock is unusual. Unlike a typical stock investment which, at least in theory, offers the possibility of an unlimited return each year, so long as the investment is maintained, the maximum eventual amount of the return on Class C stock is fixed in a single year—the year in which the investment is made—by reference to that year's earnings. At the end of that year, the total amount which the stockholder will ultimately receive in cash is known, and is an amount in excess of its investment. It is the sum of (1) the face amount of that year's purchased Class C stock (its original investment), (2) the face amount of that year's patronage dividend Class C stock and (3) the amount of that year's allocated surplus credit. Thereafter, the stockholder in substance owns a non-interest bearing security, purchased at a discount price equal to the cost of the purchased Class C stock, with a face amount equal to the total amount which the stockholder will ultimately receive in cash. Its investment grows in value through the mere passage of time, and thus produces a return to the stockholder. Cf. *United States v. Midland-Ross Corp.*, 381 U.S. 54.

The unusual characteristics of the return earned by Class C stock are a reflection of the fact, recognized by Judge Godbold in his dissenting opinion below (R. 358-359), that the investment made by a member in its cooperative is in many respects *sui generis*, and

Code), Section 1.451-1(a). The question before this Court turns on the different issue whether respondents' purchases of Class C stock resulted in the creation of an asset. Compare *Commissioner v. Lincoln Savings and Loan Association*, *supra*.

is not exactly comparable to any other investment, be it loan, corporate stock or otherwise. But given the fact that the banks are cooperatives rather than ordinary corporations, the different way in which the banks divide their profits is immaterial. All that matters is that, in substance, purchasers of Class C stock have the opportunity to earn a return on the funds they invest.²³

2. *The stock has intrinsic value*

Apart from any patronage dividends and allocated surplus credits arising from their purchase of Class C stock, farmer cooperatives stand to derive other benefits grounded in the intrinsic value of the stock as a capital contribution to a cooperative under the plan established by Congress. See R. 372 (dissenting opinion).

While patronage dividends and allocated surplus credits are the "benefits * * * more easily perceived because in the more conventional garb of dollars" (R. 369 (dissenting opinion)), ownership in the bank conferred by Class C stock involves other benefits and values. Respondents are in a position to obtain lower interest rates on their borrowings. Furthermore, their decision to

²³ Of course, there is a possibility, somewhat remote, that a cooperative will earn no return on its Class C stock if the bank is unprofitable, or even that it will suffer a loss on the stock. This possibility does not make the stock any less an asset, but rather emphasizes that it is an equity interest. See *Warren v. King*, 108 U.S. 389, 399. Likewise, the uncertainty as to the precise future time when benefits will be received is in no way inconsistent with treatment of purchased Class C stock as an asset. Compare *Commissioner v. Lincoln Savings and Loan Association*, *supra*.

capitalize the bank for their exclusive use has given them great financial power "through ultimate substantial ownership of the established, fully capitalized, staffed, and accepted financial institution" (R. 368 (dissenting opinion)). At the present time the actual control of the banks is shared with the government, since the government was for so many years the chief source of the banks' capital. But the substitution of cooperative for government capital has brought the banks a long way toward the eventual goal of member control (R. 164-168).²⁴ In actual fact, as the banks have retired more government stock, their members have achieved greater operational and voting control over them.²⁵

In answer to respondents' contention below that only the government and the banks benefit from the

²⁴ The banks themselves realize, however, that "[j]ust as commercial banks have Governmental supervision," so they will also always have such supervision (R. 181).

²⁵ Cooperatives were entitled to elect one member of the bank's seven-man board of directors before 1967, but are now entitled to elect two members. The Land Bank and Production Credit Associations elect four of the other members, while one member is appointed by the Farm Credit Administration Governor. (R. 144-145, 168, 175-176, 181; Sec. 5(d)(2)(C) of the Farm Credit Act of 1937, Appendix B, *infra*, pp. 59-61.) During most of the years here in issue, respondents each had a director on the board (R. 226-227). The regional bank boards now elect 12 of the 13 Central Bank board members, the thirteenth being appointed by the Farm Credit Administration Governor (Sec. 31(a); R. 179-180). Before 1960, only three of the then seven-man Central Bank board were elected by regional banks and their members (Sec. 31 of the 1933 Act, as amended by Sec. 104 of the 1955 Act, 69 Stat. 655, 659-660; R. 175). The regional banks, together with the Land Bank and Production Credit Associations, also elect nominees, appointable by the President, for 12 of the 13 positions on the Federal Farm Credit Board (Sec. 4(a), (d), Farm Credit Act of 1953, Appendix B, *infra*, pp. 63-64).

required capital contributions in the form of Class C stock, we quote the colloquy between the president of a bank and the originator of the banks' revolving fund capitalization system, Mr. S. D. Sanders (R. 166):

Some of the presidents doubted that the [revolving capitalization] plan would work. As one president said, the members of the cooperatives in his district "want all of the control and want everything delivered to them and they give nothing." They had this attitude toward both their local cooperative and the bank for cooperatives.

To this Mr. Sanders said: "In my way of thinking the philosophy of those men is very unsound all the way through. All interested in the farmers' welfare must recognize that no one on earth is going to change the status of the farmer but the farmer himself, and must realize that the bank for cooperatives is a business institution and requires capital, and furthermore that the capital must be furnished by the farmers (through their cooperatives) if they expect to have control of their credit system. That is just good common sense."

These capital contributions—the Class C stock purchases—have also enabled members to obtain many unique and valuable services from the banks. Contrary to the opinion of the Fifth Circuit majority (R. 352), member-cooperatives do not receive all services furnished by the New Orleans Bank merely by purchasing the first \$100 eligibility share.²⁶ True, the bank

²⁶ Each shareholder in the Banks for Cooperatives has only one vote, regardless of the number of shares it owns, unlike a common stockholder in an ordinary corporation. But this characteristic is one of the distinguishing features of a co-

will "[w]ithin the limitations of its staff * * * work with any farmer cooperative * * * whether a stockholder or not * * *" (R. 179). But this offer is a type of promotional service given to farmer cooperatives to insure that they will develop and prosper and thus use the lending resources of the banks (R. 144, 160-161).

The great majority of the types of services rendered by the banks, including budgeting, financial planning, operating trend analysis, credit policies, and auditing standards (R. 160-161, 179), are given in connection with loans taken out by the members. For example, a New Orleans Bank Annual Report (R. 144) states that "[a]s a loan service the bank continues to make

operative, and is necessary because each shareholder is also a customer of the cooperative. See *Keystone Automobile C. Cas. Co. v. Commissioner*, 122 F. 2d 886, 889-890 & n. 6; *Frost v. Corporation Commission*, 278 U.S. 515, 536-537 (Brandeis, J., dissenting); Packel, *The Law of Cooperatives* (3d ed.), pp. 68, 85-86, 138-140; see also Sec. 15 of the Agricultural Marketing Act, as amended by Section 12 of the Farm Credit Act of 1935, Appendix B, *infra*, p. 47. The fact that respondents have given up greater voting rights for the opportunity to share in the possibly greater benefits offered by a cooperative enterprise surely cannot mean that their Class C common stock is not a valuable asset. Transferability of the common stock of a cooperative is also more limited than in the case of the stock of an ordinary corporation. This limitation is grounded in the cooperative principle requiring the business to be owned principally by patrons interested in receiving satisfactory and inexpensive service, rather than by non-patron investors interested in maximum profits directly from their investments in the cooperative. In the absence of the limitation, a conflict of interest may develop between patrons and investors. Nieman, *Revolving Capital in Stock Cooperative Corporations*, 13 Law and Contemporary Problems, p. 396 & n. 12; see Packel, *supra*, pp. 127-129; Evans and Stokdyk, *The Law of Agricultural Cooperative Marketing*, (1937), pp. 58-65.

regular field visits to *borrowing cooperatives* to the extent possible with available personnel." (Emphasis added.) Another Banks for Cooperatives publication summed up the matter of services as follows (R. 179): "In short, the Banks for Cooperatives provide farmer cooperatives a complete and specialized credit service which *gives the money they lend* extra value." (Emphasis added.) The court of appeals' statement (R. 352), that "the right to Bank services is established by the purchase of the initial qualifying shares," is erroneous to the extent that it implies that members with one share of stock receive services from the bank as extensive as those received by large and frequent borrowers and Class C stock purchasers."

It does not follow from the fact that payments for Class C stock can be viewed as payments for services that the stock is without long-term value, and that the payments are thus merely a current cost of doing business. The stock's long-term value would be clear, we submit, if Congress had required member-cooperatives to subscribe to a large amount of stock in the Banks for Cooperatives as a condition to joining and becoming eligible for their many services—including the right to borrow money—without regard to the amount they might borrow. The stock is no less valuable because Congress has keyed the time and amount of the stock subscription to the loan and interest billings, in all likelihood for the convenience of members (R. 366 (dissenting opinion)).

²⁷ The district court made no findings with respect to the services provided by the Banks for Cooperatives.

Respondents (Br. in Opp. 8-9) and the courts below (R. 344, 351-352) stress the differences between the Class C stock of the banks and the stock of an ordinary corporation, and have concluded that, while the latter is valuable, the former is not. But these differences are not adequate to support the conclusion. The primary difference between the common stock of a cooperative and that of an ordinary corporation is that common stock ownership in a cooperative does not, in and of itself, entitle one to a share in the distribution of each year's profits. A cooperative stockholder must normally in any year fulfill the additional requirement of patronizing the cooperative. Its share of the profits pool will then consist of the proportion its patronage bears to the total patronage of the cooperative in that year. In the case of the Banks for Cooperatives, this seeming inequality is alleviated by the fact that common stock ownership is itself proportionate to each member's yearly patronage. Unlike cooperatives, stockholders in an ordinary corporation obtain what a leading cooperative law commentator has termed "entrepreneur profit," that is, a share of the profits of the corporation in each year based on total stock owned. See Packel, *The Law of Cooperatives* (3d ed.), pp. 2-3, quoted by the dissent below (R. 360-361); see also *Frost v. Corporation Commission*, 278 U.S. 515, 536-537 (Brandeis, J., dissenting). But in a cooperative, the members must provide the capital for the venture, and the different way in which the profit of a cooperative corporation is allocated does not make the member's stock any less capital or any less valuable than stock in an ordinary corporation, especially in view of the other

long-term service benefits which a member derives from the capitalization of a cooperative corporation.

It is a basic income tax principle that one may not deduct a contribution to an ordinary corporation's capital as an ordinary and necessary business expense,²⁸ as a loss,²⁹ or as a worthless debt,³⁰ because the stock received in return is a capital item having a useful life extending substantially beyond the close of the taxable year. The same principle would preclude the deduction of such a contribution as interest, because only interest "paid or accrued within the taxable year * * *" is deductible under Code Section 163. Since, as we have shown, the cooperative stock here in question, like the stock of an ordinary corporation, has continuing value, capital contributions to the Banks for Cooperatives should not be currently deductible.³¹

²⁸ *E.g.*, *Island Petroleum Co. v. Commissioner*, 17 B.T.A. 1, 10-11, affirmed, 57 F. 2d 992, 994-995 (C.A. 4), certiorari denied, 287 U.S. 646; *Wilson v. Commissioner*, 40 T.C. 543, 551.

²⁹ *E.g.*, *Lutz v. Commissioner*, 2 B.T.A. 484; *Paxton v. Commissioner*, 7 B.T.A. 92.

³⁰ *E.g.*, *In re Park's Estate*, 58 F. 2d 965 (C.A. 2), certiorari denied, 287 U.S. 645.

³¹ See *Paducah & Illinois Railroad Co. v. Commissioner*, 2 B.T.A. 1001, 1006-1007; *874 Park Avenue Building Corporation v. Commissioner*, 23 B.T.A. 400. It is settled law that contributions to capital do not constitute income either to an ordinary corporation or to a cooperative. See Section 118 of the Internal Revenue Code; *Garden Homes Co. v. Commissioner*, 64 F. 2d 593 (C.A. 7); *Cambridge Apartment Building Corp. v. Commissioner*, 44 B.T.A. 617; *Farmers Cooperative v. Birmingham*, 86 F. Supp. 201, 236-237 (N.D. Iowa).

D. EVEN IF THE STOCK HAS ONLY NOMINAL VALUE, ITS ENTIRE
COST MUST BE CAPITALIZED

Unless the Court rejects all of our preceding arguments, there will be no need to reach the question whether, if the Class C stock purchased by respondents has only nominal value, its entire cost nevertheless must be capitalized. Our position is, however, that even if this is the case, no deduction is justified.

As a preliminary matter, it is important to note that Class C stock has limited value if it is viewed, as respondents contend it should be, as conferring upon them nothing more than the right to a return of their payments at an indefinite future time. The value may not be susceptible of quantification, but since one would rather have the right than not have it—all other things being equal—it is fair to conclude that the right has a value, whatever it might be.

With this in mind, we turn again to Section 1.461-1 (a)(2) of the Treasury Regulations. It provides that “any expenditure which results in the creation of an asset having a useful life extending substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred.” Nothing in the Regulations suggests that, for the rule of nondeductibility to apply, the asset created must have a value equal to or greater than the expenditure made. All that is required is that an item of value be created. An item of limited value fits within this description.

Until the decision of the Court of Claims in *Penn Yan Agway, supra*, it had uniformly been held that

where one pays more for an asset than it is worth—a situation which in our view does not exist here—realization of any loss must await a sale or other disposition, or complete worthlessness.³² The court below felt free to depart from this rule for two reasons. First, following the opinion of the Court of Claims in *Penn Yan Agway* (417 F. 2d at 1379), the court felt that it would be unfair to apply the rule where, as here, the restrictions on transferability precluded respondents from selling their stock and realizing the loss (R. 355). Second the court stated (R. 355) that the cases establishing the rule were distinguishable, since in those cases the taxpayers had been the victims of bad bargains.

These considerations do not justify a departure from the familiar principle that only losses “actually sustained during the taxable year” may be deducted, and that “a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed or completed transactions and as fixed by identifiable events occurring in such taxable year.” Treasury Regulations on Income Tax, Section 1.165-1 (a) and (d)(1). Indeed, the second consideration referred to by the court of appeals would seem to place respondents in a weaker position to claim relief

³² See, e.g., *Montana Power Co. v. United States*, 159 F. Supp. 593, 594 (Ct. Cl.), certiorari denied, 358 U.S. 842; *Booth Newspapers, Inc. v. United States*, 303 F. 2d 916, 922 (Ct. Cl.); *Koppers Co. v. United States*, 278 F. 2d 946, 949 (Ct. Cl.); *Dresser v. United States*, 55 F. 2d 499, 512 (Ct. Cl.), certiorari denied, 287 U.S. 635; *Chase Candy Co. v. United States*, 126 F. Supp. 521 (Ct. Cl.).

on some equitable ground than those taxpayers who were the victims of bad bargains.

Nor can respondents escape the rule requiring the realization of losses by claiming interest and expense deductions under Sections 163(a) and 162(a). This Court has repeatedly recognized that the cost of an asset may be recovered only when a loss is sustained, unless the asset is subject to depreciation or amortization. See, e.g., *Woodward v. Commissioner*, 397 U.S. 572, 574-575; *Commissioner v. Tellier*, 383 U.S. 687, 689-690; *Helvering v. Winmill*, 305 U.S. 79.³³

³³ Respondents are not helped by cases purporting to apply the rationale of *Corn Products Co. v. Commissioner*, 350 U.S. 46, and permitting ordinary loss treatment on the sale of corporate stock, on the ground that the stock was purchased and held incident to the taxpayer's business, rather than as an investment. E.g., *Booth Newspapers, Inc. v. United States*, 303 F. 2d 916 (Ct. Cl.); *Western Wine & Liquor Co. v. Commissioner*, 18 T.C. 1090. Apart from the question whether such ordinary loss treatment is within the proper scope of *Corn Products*, the issue in these cases is whether the stock sold was a capital asset within the meaning of Section 1221. (It was assumed in each case that the stock was an asset.) Here, on the other hand, there has been no sale, and the issue is whether the stock purchased is an asset, not whether it is a capital asset. We read *McMillian Mortgage Co. v. Commissioner*, 36 T.C. 924, as also involving the capital asset question—there in the context of sales of FNMA stock acquired in exchange for mortgages. To the extent that *Ancel Greene & Co. v. Commissioner*, 38 T.C. 125, is contrary to our position, it would also seem contrary to *Helvering v. Winmill*, *supra*, which recognizes that a dealer in securities must capitalize their cost on acquisition. But *Greene* can be harmonized with *Winmill* by reading it as involving realized losses sustained on the exchange of mortgages for stock, rather than a purchase of stock. At all events, both the *McMillian* and *Greene* decisions are of limited precedential value, since ordinary deductions upon acquisition of FNMA stock in exchange for mortgages are now permitted.

F. THE USURY AND BONUS PAYMENT CASES RELIED ON BY THE COURT BELOW DO NOT SUPPORT RESPONDENTS' CONTENTION THAT PAYMENTS FOR CLASS C STOCK CONSTITUTE INTEREST

The court below (R. 356-357 & n. 31) and the Court of Claims in *Penn Yan Agway* (417 F. 2d at 1379) relied heavily on opinions by the Tenth Circuit in two usury cases (*Oil City Motor Co. v. C.I.T. Corp.*, 76 F. 2d 589, 591, and *Memorial Gardens of Wasatch, Inc. v. Everett Vinson & Associates*, 264 F. 2d 282, 285), for the proposition that—

if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest and will be taken into account in determining whether the transaction is usurious. * * *

But this principle has no application here because the Banks for Cooperatives do not require their members to "purchase property from * * * [them] at an excessive price." As we have shown, the Class C stock required to be purchased represents the provision of capital for the banks, and, in substance in the light of the cooperative scheme of business organization, bears a return and also has intrinsic value. Moreover, the courts have consistently held the principle relied on below inapplicable to stock payments by borrowers to cooperative lending institutions similar to the Banks for

only by virtue of a special provision of the Code (Section 162(d)), specifically limited to these transactions, and excepting them from the rule otherwise applicable to the costs of acquiring an asset.

Cooperatives. These holdings actually support our position that the payments in question constitute capital contributions rather than interest.

Building and Loan Ass'n v. Price, 169 U.S. 45, involved a contract by a building and loan association, a type of cooperative (see Packel, *The Law of Cooperatives* (3d ed.), p. 22-23),³⁴ to lend \$2,000 at the maximum allowable legal interest rate, on condition that the borrower contemporaneously subscribe to \$4,000 par value of the association's stock. The contract provided that payments on the stock subscription were to be made simultaneously with the interest payments on the loan. As in the instant case, the stock payments served as collateral for the loan. This Court held that the payments on the stock did not constitute interest, and that the loan therefore was not usurious, concluding (pp. 53-54):

The stock is not, as is claimed by counsel for appellee, a mere fiction. * * * [The owner's] position of shareholder is entirely separate from his position of borrower from the company.

In *Gunby v. Armstrong*, 133 Fed. 417, 430-432 (C.A. 5), a similar loan-stock purchase agreement of a building and loan association was involved. As in the instant case, there existed different classes of stock, some of which were noninterest bearing. Noting that the loan agreement "on its face * * * [was] for legal interest

³⁴In Massachusetts, building and loan associations are often referred to as "cooperative banks." See, e.g., *Lexington Co-operative Bank v. Commissioner of Banks*, 327 Mass. 624, 100 N.E. 2d 18; *Commissioner of Banks v. Fitchburg Co-operative Bank*, 329 Mass. 401, 108 N.E. 2d 542.

only," the court stated that the borrower had not borne his burden of proving "that there was some corrupt agreement, or device or shift, to cover usury * * *", quoting *United States Bank v. Waggener*, 9 Pet. 378, 399. It held that the two contracts of loan and stock subscription were to be regarded as "separate and distinct" and, in consequence, that the loan was not usurious. While there was at first some confusion among the state courts in interpreting such loan-stock subscription agreements, they have almost all adopted the conclusion set forth in the cases discussed above, that, in the absence of a showing of a corrupt agreement or device to mask usury, payments on a stock subscription are not to be regarded as adding to the amount of interest paid pursuant to the loan agreement.³⁵

The Tenth Circuit decisions are not inconsistent with the building and loan association cases. In *Memorial Gardens, supra*, the court did not state the general principle upon which respondents rely as an absolute. Rather, it qualified the principle (264 F. 2d at 284-285) with the requirement that the borrower who is required to purchase property in connection with a

³⁵ See, e.g., *Pacific States Savings, Loan & Bldg. Co. v. Green*, 123 Fed. 43 (C.A. 9), and *Fidelity Sav. Ass'n v. Bank of Commerce*, 12 Wyo. 315, 75 Pac. 448, which discuss the numerous cases; compare *Bedford v. Eastern Building and Loan Ass'n*, 181 U.S. 227, 242-243 (interpreting New York law), *Manship v. New South Building & Loan Ass'n*, 110 Fed. 845 (SD. Miss.), and *Bank of Loudon v. Armor*, 90 Miss. 709, 44 So. 66 (interpreting Mississippi law), with *National Mutual B. & L. Assn. v. Brahan*, 193 U.S. 635 (noting the earlier Mississippi law); see generally 12 C.J.S., *Building and Loan Associations*, Sec. 78b.

loan must show that the sale of the property was "a subterfuge to cover up the true intent of the parties and that it was * * * the purpose or intent of the parties that the transaction should, in fact, be one for the loan or forbearance of money * * *." On the facts, the court held that the borrower had not made the required showing. In *Oil City, supra*, the court merely recognized the general proposition that a requirement that a borrower purchase property at an inflated price as a condition for a loan might constitute usury, but had no need to apply the principle in any way, and thus no occasion to spell out the qualifications to which the principle is subject.

In *Continental Savings & Building Ass'n v. Wood*, 33 S.W. 2d, 770, 772 (Tex. Civ. App.), the court held that the statutes regulating building and loan association loan agreements and stock subscriptions did not constitute a "device" for allowing usurious interest. It refused to presume a legislative intention to violate state constitutional and statutory usury proscriptions. Any contention that the interest and stock payments here were not separate items within the understanding of the parties also must fail, since the loans and stock purchases were made pursuant to statutory and administrative directives clearly evidencing that the transactions were separate.³⁶ Compare

³⁶ Respondents (Br. in Opp. 3) and the court of appeals (R. 349) refer to the Class C stock payments as "interest override." But this term nowhere appears in the legislation enacted by Congress or in the pertinent administrative regulations. As the President of the New Orleans Bank for Cooperatives, who was respondents' witness, testified with respect to the origin of the term (R. 256): "We coined it in the Bank (laugh) and our

Sec. 8 of the Agricultural Marketing Act, Appendix B, *infra*, p. 47, and Farm Credit Adm. Regs., Sec. 70.90, Appendix B, *infra*, pp. 64-65, with Sec. 42(a) of the Farm Credit Act of 1933 and Farm Credit Adm. Regs., Sec. 70.142, *supra*.

The bonus payment cases relied on by the court below (R. 356 & n. 30)³⁷ likewise are not relevant to the question here. As recognized by the district court in *M.F.A. Central Cooperative, supra*, 286 F. Supp. at 959:

These [bonus payment] cases are distinguishable from the present matter, because in each * * * the debtor parted with the additional money and received nothing in return other than the use of the lender's money. In the present situation, * * * [the borrower] parted with the additional money and received stock in the * * * Bank, which had a corresponding face value.

This distinction is one which is commonly made in the building and loan association cases, payments for stock being consistently treated as capital investments; while "premiums" paid for the use of the money borrowers, I think, picked it up also." The self-serving phrase cannot serve as a substitute for the congressional judgment regarding the nature of Class C stock.

³⁷ *Wiggins Terminals, Inc. v. United States*, 36 F. 2d 893 (C.A. 1); *L-R Heat Treating Co. v. Commissioner*, 28 T.C. 894; *Court Holding Co. v. Commissioner*, 2 T.C. 531, 536, reversed on other grounds, 143 F. 2d 823 (C.A. 5), court of appeals reversed and Tax Court affirmed on other grounds, 324 U.S. 331. The Court of Claims relied on the same cases in *Penn Yan Agway, supra*, 417 F. 2d at 1379.

are often held to constitute usurious interest if not specifically allowed by statute.³⁸

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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³⁸ See, e.g., *Douglass v. Kavanaugh*, 90 Fed. 373 (C.A. 6); see generally. Annotation, Non-compliance with conditions prescribed by statute as affecting validity of contract, under usury laws, for payment of premium on loan of building and loan association," 74 A.L.R. 973; Sundheim, *Law of Building and Loan Associations* (1933), pp. 150-151; 13 Am. Jur. 2d, Building and Loan Associations, Sec. 59; 12 C.J.S., *supra*, Sec. 73b.

APPENDIX A

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

SEC. 163. INTEREST.

(a) *General Rule.*—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

SEC. 1.461-1 *General rule for taxable year of deduction.*

(a) *General rule.*—(1) * * *

(2) *Taxpayer using an accrual method.*

Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. However, any expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred. While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of the liability which has been incurred cannot be determined will not prevent the accrual within the taxable year of

such part thereof as can be computed with reasonable accuracy. For example, A renders services to B during the taxable year for which A claims \$10,000. B admits the liability to A for \$5,000 but contests the remainder. B may accrue only \$5,000 as an expense for the taxable year in which the services were rendered. In the case of certain contested liabilities in respect of which a taxpayer transfers money or other property to provide for the satisfaction of the contested liability, see § 1.461-2. Where a deduction is properly accrued on the basis of a computation made with reasonable accuracy and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made.

* * * *

APPENDIX B

Agricultural Marketing Act, c. 24, 46 Stat. 11:

SEC. 8 [as amended by Sec. 109, Farm Credit Act of 1955, c. 785, 69 Stat. 655, 662]. (a) Loans to cooperative associations made by any bank for cooperatives shall bear such rates of interest as the board of directors of the bank shall from time to time determine with the approval of the Farm Credit Administration, but in no case shall the rate of interest exceed 6 per centum per annum on the unpaid principal of a loan.

* * * * *

[12 U.S.C. 1141f.]

SEC. 15 [as amended by Sec. 12, Farm Credit Act of 1935, c. 164, 49 Stat. 313, 317]. (a) As used in this Act, the term "cooperative association" means any association in which farmers act together in processing, preparing for market, handling, and/or marketing the farm products of persons so engaged, and also means any association in which farmers act together in purchasing, testing, grading, processing, distributing, and/or furnishing farm supplies and/or farm business services: *Provided, however,* That such associations are operated for the mutual benefit of the members thereof as such producers or purchasers and conform to one or both of the following requirements:

First. That no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein; and

Second. That the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum.

* * * * *

[12 U.S.C. 1141j.]

Farm Credit Act of 1933, c. 98, 48 Stat. 257:

SEC. 2 [as amended by Sec. 105(a), Farm Credit Act of 1956, c. 741, 70 Stat. 659, 665]. The Governor of the Farm Credit Administration, hereinafter in this Act referred to as the "Governor", is authorized and directed to organize and charter twelve banks to be known as "banks for cooperatives". One such bank shall be established in each city in which there is located a Federal land bank. The members of the several farm credit boards of the farm credit districts provided for in section 5 of the Farm Credit Act of 1937, as amended, shall be ex officio the directors of the respective banks for cooperatives. Such directors shall have power, subject to the approval of the Governor, to employ and fix the compensation of such officers and employees of such banks as may be necessary to carry out the powers and duties conferred upon such banks under this Act.

* * * * *

[12 U.S.C. 1134.]

SEC. 31. [as amended by Sec. 1, Act of June 11, 1960, P.L. 86-503, 74 Stat. 197]. **BOARD OF DIRECTORS OF THE CENTRAL BANK.**—

(a) The Central Bank for Cooperatives shall have thirteen directors, one from each of the twelve farm credit districts and a director-at-large. The director-at-large shall be appointed by the Governor by and with the advice and consent of the Federal Farm Credit Board. Initially, directors from six of the farm credit districts shall be appointed by the Governor by and with the advice and consent of the Federal Farm Credit Board and directors from the other six farm credit districts shall be elected by the board of directors of the regional bank for cooperatives in the district. The Farm Credit Administration shall designate the districts which shall be represented by appointed directors and which by elected directors. Except as otherwise required under subsections (b) and (c) of this section, a director appointed

for a district shall be succeeded by a director elected in the same district and a director elected in a district shall be succeeded by a director appointed for the same district. The term of office of a director shall be three years, except that the terms of office for directors other than the director-at-large which begins January 1, 1961, shall be one year, two years, and three years, divided equally among elected and appointed directors as designated by the Farm Credit Administration. The Farm Credit Administration shall prescribe rules and regulations and take all other action necessary to permit the elections required by this section.

(b) Whenever, as of June 30, of any year, the Farm Credit Administration determines that the sum of the capital stock and subscriptions to the guaranty fund of the Central Bank held by persons other than the Governor on behalf of the United States and surplus and reserve accounts of said bank equals or exceeds $66\frac{2}{3}$ per centum of the total capital stock, subscriptions to the guaranty fund and surplus and reserve accounts of said bank, the directors from the farm credit districts for the terms beginning the next succeeding January 1 shall all be elected by the board of directors of the regional bank for cooperatives in the respective districts.

* * * * *

[12 U.S.C. 1134g.]

Sec. 36 [as amended by Sec. 103, Farm Credit Act of 1955, *supra*, and Sec. 2, Act of October 3, 1961, P. L. 87-343, 75 Stat. 758].

(a) *Application of Savings*.—Each bank for cooperatives, at the end of each fiscal year, shall determine the amount of its net savings after paying or providing for all operating expenses (including reasonable valuation reserves and losses in excess of any such applicable reserves) and shall apply such savings as follows: (1) To the restoration of the amount of the impairment, if any, of capital stock, as determined by

its board of directors; (2) 25 per centum of any remaining savings shall be used to create and maintain a surplus account; (3) if said bank shall have outstanding capital stock held by the United States during the whole or any part of the fiscal year, it shall next pay to the United States as a franchise tax, a sum equal to 25 per centum of its net savings then remaining, not exceeding, however, a rate of return on such Government capital calculated at a rate equal to the computed average annual rate of interest on all public issues of public debt obligations of the United States issued during the fiscal year ending next before such tax is due, as certified to the Farm Credit Administration by the Secretary of the Treasury; (4) reasonable contingency reserves may be established; (5) dividends on class B stock may be declared as provided in section 42 (a) (2); and (6) any remaining net savings shall be distributed as patronage refunds as provided in subsection (b) of this section: *Provided*, That any patronage refunds received by a regional bank from the central bank shall be excluded from net savings of the regional bank for the purpose of computing such franchise tax. Amounts applied as provided in (2) and (4) above after the effective date of title I of the Farm Credit Act of 1955 shall be allocated on a patronage basis approved by the Farm Credit Administration. At the end of any fiscal year, any portion of the reserve established under (4) above which is no longer deemed necessary shall be transferred to the surplus account and, if the surplus account of any such bank for cooperatives exceeds 25 per centum of the sum of all its outstanding capital stock, the bank may distribute in the same manner as a patronage refund any part or all of such excess which has been allocated: *Provided*, That any surplus and contingency reserves shown on the books of the banks as of the effective date of title I of the

Farm Credit Act of 1955 shall not be distributed as patronage refunds. In making such distributions, the oldest outstanding allocations shall be distributed first. Wherever used in this Act, the words "surplus account" as applied to any bank for Cooperatives shall mean any surpluses and contingency reserves shown on the books of the banks as of the effective date of title I of the Farm Credit Act of 1955 and any amounts applied as provided in (2) above after the effective date of said title I. Said surplus account shall be divided to show the amounts thereof subject to allocation as provided in this section and may be further subdivided as prescribed by the Farm Credit Administration. In the event of a net loss in any fiscal year after providing for all operating expenses (including reasonable valuation reserves and losses in excess of any such applicable reserves), such loss shall be absorbed by: first, charges to allocated contingency reserves; second, charges to allocated surplus; third, charges to other contingency reserves and surplus; fourth, the impairment of class C stock; and fifth, the impairment of all other stock.

(b) *Patronage Refunds.*—The patronage refunds of each regional bank for cooperatives shall be paid in class C stock to borrowers, as defined by the Farm Credit Administration for the purposes of this subsection, during the fiscal year for which the refunds are declared. Patronage refunds of the Central Bank for Cooperatives shall be paid in class C stock to the regional banks for cooperatives upon the basis of interests held by the central bank in loans made by the regional banks and upon direct loans made by the central bank to cooperative associations; and any part of such refunds derived from such direct loans of the central bank shall be paid in class C stock issued to the regional bank or banks which issued to the bor-

rower the stock incident to the loans, or to a regional bank or banks designated by the Farm Credit Administration, and such bank or banks shall issue a like amount of class C stock to the borrowers. All patronage refunds shall be paid in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year.

(c) *Application of Assets on Liquidation or Dissolution.*—In the case of liquidation or dissolution of any bank for cooperatives, after the payment or retirement, as the case may be, first, of all liabilities; second, of all capital stock issued before the effective date of title I of the Farm Credit Act of 1955 held by cooperative associations at par, all class A stock at par, and all class B stock at par; and third, of all class C stock at par; any surpluses and contingency reserves existing on the effective date of said title I shall be paid to the holders of outstanding capital stock issues before the effective date of said title I, class A stock and class C stock pro rata, and any remaining surplus and contingency reserves shall be distributed to those entities to which they are allocated on the books of the bank. If it should become necessary to use any surplus or contingency reserves to pay any liabilities or to retire any capital stock, allocated contingency reserves and surplus shall be exhausted first in accordance with rules prescribed by the Farm Credit Administration.

(d) Notwithstanding any other provision of this Act, in the case of liquidation or dissolution of any present or former borrower from a bank for cooperatives, the bank, may, in accordance with rules and regulations prescribed by the Farm Credit Administration, retire and cancel any capital stock or allocated surplus and contingency reserves or other equity interest, in the bank owned by such borrower at the fair

book value thereof, not exceeding par, and, to the extent required, corresponding shares and allocations or other equity interests held by the regional bank in the central bank shall be retired:

[12 U.S.C. 1134/.]

* * * *

SEC. 42 [as amended by Sec. 101, Farm Credit Act of 1955, *supra*]. (a) *Classes of Stock; Ownership; Voting Rights; Dividends; and Retirement of Stock.*—Except as provided in section 111 of the Farm Credit Act of 1955, each regional bank for cooperatives shall have the following classes of stock, all of which shall have a par value of \$100 per share:

(1) Class A stock shall be issued to and held by the Governor of the Farm Credit Administration on behalf of the United States, and stock of such banks held by the Governor on the effective date of title I of the Farm Credit Act of 1955 shall be exchanged, share for share, for class A stock of the respective banks. Class A stock shall be nonvoting and no dividends shall be paid thereon. At the end of each fiscal year, each of such banks, subject to the provisions of sections 33 and 40, shall determine the amount of class A stock that shall be retired at par by that bank. The minimum amount of class A stock that shall be retired shall be the equivalent in dollar value of the amount of class C stock issued for that year, except that class C stock issued by a regional bank on account of class C stock issued to it by the central bank, class C stock issued by a regional bank in exchange for class B stock the proceeds of which were used to retire an equivalent amount of class A stock, and class C stock issued by a regional bank in exchange for capital stock of the bank outstanding on the effective date of title I of

the Farm Credit Act of 1955, shall not be included in such bank's calculation. Any amount of class A stock retired in excess of such minimum amount in one year may be used to reduce to that extent the amount of such stock required to be retired in any subsequent year. Funds from the retirement of class A stock shall be paid into the revolving fund authorized by the Agricultural Marketing Act, as amended, and shall continue to be available for the purchase of class A stock in the banks in accordance with sections 33 and 40.

(2) Class B stock may be issued in series and amounts approved by the Farm Credit Administration, and may be sold or transferred to any person subject to the approval of the issuing bank. Such stock shall be issued only at par and shall be non-voting. Any bank may pay dividends of not to exceed 4 per centum per annum on class B stock if declared by the board of directors and approved by the Farm Credit Administration and if the surplus account of the bank, after payment of such dividends, will not be less than 25 per centum of the sum of all its outstanding capital stock. Dividends on class B stock shall not be cumulative, but no bank shall distribute in any year any of its net savings as patronage refunds as provided in section 36 (a) unless for that year a dividend of at least 2 per centum is declared and paid upon outstanding class B stock of the bank. Each series of class B stock shall be issued only with the approval of the Farm Credit Administration and shall carry on the face of each certificate a statement of the maximum dividend which may be declared and paid thereon and of the minimum dividend which shall be declared and paid thereon before the bank may distribute any of

its net savings as patronage refunds: *Provided*, That such maximum and minimum dividends may be the same amount. After all class A stock has been retired, class B stock may be called for retirement at par with the approval of the Farm Credit Administration and shall be called in such manner that the oldest outstanding stock at any given time will be retired first. Any holder of class B stock whose stock has been called for retirement may elect, with the approval of the issuing bank, to leave his stock in the bank subject to its being included in the next call for retirement.

(3) Class C stock, except as approved by the Farm Credit Administration and consented to by the issuing bank, may be issued only to banks for cooperatives and farmers' cooperative associations as defined in section 15 (a) of the Agricultural Marketing Act, as amended. Such stock may be issued in fractional shares, shall be issued at its fair book value not exceeding par, as determined by the bank, and no dividends shall be paid on it. Each holder of one or more shares of class C stock which is eligible to borrow from a bank for cooperatives shall be entitled to one vote only: *Provided*, That any such holder which within the period of two years next preceding a date, fixed by the Farm Credit Administration, prior to commencement of the voting has not been a borrower from a bank of which it holds class C stock shall not be entitled to vote. From time to time each bank for cooperatives shall obtain information concerning its class C stockholders to determine whether they continue to be eligible to borrow from the bank and to vote. Any class C stockholder found by the bank to be ineligible to borrow shall not be entitled to vote until its eligibility is

reestablished to the satisfaction of the bank. Whenever in section 5 of the Farm Credit Act of 1937, as amended, and section 4(a) of the Farm Credit Act of 1953, provision is made for a nomination or election by cooperatives which are stockholders or subscribers to the guaranty fund of any bank for cooperatives the term 'cooperatives which are stockholders or subscribers to the guaranty fund' or the equivalent of that term, shall mean such cooperatives which are eligible to vote. Each borrower from a bank for cooperatives shall be required to own at the time the loan is made at least one share of class C stock. The purchase price of such stock may be retained out of the loan. In addition, each borrower as defined by the Farm Credit Administration for purposes of this sentence, shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by it to the bank during the calendar quarter. Payments for such stock shall be made quarterly or when the regular interest payments of the borrower are payable, but the stock shall be issued to the borrower as of the end of each fiscal year in the amount of the payments for stock made by it during the year. Each regional bank shall purchase at least one share of class C stock of the central bank. In addition, the regional bank shall be required to invest quarterly in class C stock of the central bank an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the central bank with the approval of the Farm Credit Administration, of the amount of interest pay-

able by the regional bank to the central bank during the calendar quarter by reason of any interest purchased by the central bank in a loan made by the regional bank. Payments for such stock shall be made to the central bank and the stock shall be issued to the regional bank in the same manner, insofar as practicable, as is provided in this section for payments for and issuance of stock on account of loans by the regional bank in which the central bank does not purchase any interest. Subject to rules prescribed by the board of directors of the lending bank with the approval of the Farm Credit Administration a borrower may convert class B stock into class C stock for the purpose of making the investment in class C stock required by this paragraph. After retirement of all class A stock, class C stock also may be retired at par by calling the oldest outstanding class C stock, but class C stock that was issued for a fiscal year period shall not be called for retirement until all class B stock that was issued during or prior to that fiscal year has been called for retirement.

* * * * *

(c) *Lien on Stock*.—Except as hereinafter provided in the case of an association which is a direct borrower from the central bank, each bank for cooperatives shall have a first lien on all stock in the bank owned by each cooperative association as additional collateral for any indebtedness of such association to the bank. In the case of an association which is a direct borrower from the central bank, the central bank shall have a first lien on any amount of class C stock which the borrowing association owns in any regional bank on account of direct loans of such association from the central bank; and the regional bank shall have a lien on such stock junior only to the lien of the central bank. In

any case where the debt of a borrower is in default, the bank may in accordance with regulations of the Farm Credit Administration, retire and cancel all or a part of the stock of the defaulting borrower at the fair book value thereof, not exceeding par, in total or partial liquidation of the debt, as the case may be, and, to the extent required, corresponding shares held by a regional bank in the central bank shall be retired.

* * * * *

[12 U.S.C. 1134d.]

SEC. 63 [as amended by Sec. 105(o), Farm Credit Act of 1965, *supra*]. The Central Bank for Cooperatives, and the Production Credit Associations, and Banks for Cooperatives, organized under this Act, and their obligations, shall be deemed to be instrumentalities of the United States, and as such, any and all notes, debentures, bonds, and other such obligations issued by such banks, or associations shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority. Such banks, and associations, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such banks and associations and corporations shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed. The exemption provided herein shall not apply with respect to any production credit association or its property or income after the class A stock held in it by the Governor has been retired, or with respect to any bank for cooperatives or its

property or income after the stock held in it by the United States has been retired.

[12 U.S.C. 1138c.]

Farm Credit Act of 1937, c. 704, 50 Stat. 703:

SEC. 5 [as amended by Sec. 15, Farm Credit Act of 1953, c. 335, 67 Stat. 390, 397, and Sec. 104(h), Farm Credit Act of 1959, P.L. 86-168, 73 Stat. 384, 387].

(d) (1) The member of the farm credit board of each farm credit district known as the "third district director", who is in office on the effective date of the Farm Credit Act of 1953, shall serve as such until his term of office expires. Thereafter, there shall be no member of the district farm credit board to be known as the "third district director".

(2) Notwithstanding the above provision with respect to the appointment of district directors, one additional member of said board shall be elected by each of the groups aforesaid (Federal land bank associations and borrowers through agencies, production credit associations, and cooperatives which are stockholders or subscribers to the guaranty fund of the regional bank for cooperatives of the district), and serve in lieu of a district director, under the following circumstances and conditions:

(C) Whenever, as determined by the Farm Credit Administration, the sum of the capital stock and subscriptions to the guaranty fund held by cooperatives which are stockholders or subscribers to the guaranty fund of a regional bank for cooperatives, surplus and reserves of said bank shall equal or exceed 66 $\frac{2}{3}$ per centum of the total capital stock, subscriptions to the guaranty fund, surplus and reserves of said bank as of the date three months before the expiration of the term of office of the dis-

trict director (or third district director) whose term next expires, the successor to such director shall be elected by the cooperatives which are stockholders or subscribers to the guaranty fund of said bank in the manner herein provided, shall be known as an elected director, and successors to that office shall be so elected and known from term to term while such conditions obtain: *Provided*, That if and when, as determined by the Farm Credit Administration, such conditions do not obtain as of the date three months before the expiration of the term of office of any director so elected under the provisions of this subparagraph, the successor to such director shall be appointed by the Governor of the Farm Credit Administration by and with the advice and consent of the Federal Farm Credit Board, shall be known as a district director, and successors to that office shall be so appointed and known from term to term for such terms as appointment is not precluded by the election of an additional director by one of the groups aforesaid as herein provided: *Provided further*, That such cooperatives which are stockholders or subscribers to the guaranty fund of said bank shall again and from time to time elect one additional director as aforesaid if and when the required conditions named in this subparagraph shall be determined to obtain as aforesaid: *Provided further*, That at no time and under no conditions shall there be in office less than one or more than two members of said board who are serving by election of any one of the groups aforesaid (Federal land bank associations and borrowers through agencies, production credit associations, and cooperatives which are stockholders or subscribers to the guaranty fund of the regional bank for cooperatives of the district): *And provided further*, That if two or more of said groups shall, under the terms and provisions hereof, become qualified to elect an additional director pend-

ing the expiration of the term of office of the district director (or third district director) whose term next expires, preference shall be given, first to Federal land bank associations and borrowers through agencies, next to production credit associations, and next to cooperatives which are stockholders or subscribers to the guaranty fund of the regional bank for cooperatives, to elect an additional director as herein provided as the terms of office of district directors, including the third district director if he be still in office, expire.

(e) At least two months before an election of an elected director the Farm Credit Administration shall cause notice in writing to be sent to those entitled to nominate candidates for such elected director. In the case of an election of a director by Federal land bank associations and borrowers through agencies, such notice shall be sent to all Federal land bank associations and borrowers through agencies in the district; in the case of an election by production credit associations, such notice shall be sent to all production credit associations in the district; and in the case of an election by cooperatives which are stockholders or subscribers to the guaranty fund of the bank for cooperatives of the district, such notice shall be sent to all cooperatives which are stockholders or subscribers to the guaranty fund at the time of sending notice. After receipt of such notice those entitled to nominate the director shall forward nominations of residents of the district to the Farm Credit Administration. The Farm Credit Administration shall, from the nominations received within thirty days after the sending of such notice, prepare a list of candidates for such elected director consisting of the ten nominees receiving the highest number of votes.

(f) At least one month before the election of an elected director the Farm Credit Admin-

istration shall mail to each person or organization entitled to elect the elected director the list of the ten candidates nominated in accordance with the preceding paragraph of this section. In the case of an election of a director by Federal land bank associations and borrowers through agencies, the directors of each land bank association shall cast the vote of such association for one of the candidates on the list. In voting under this section each such association shall be entitled to cast a number of votes equal to the number of stockholders of such association and each borrower through agencies shall be entitled to cast one vote. In voting under this section each production credit association shall be entitled to cast a number of votes equal to the number of the class B stockholders of such association. In voting under this section each cooperative which is a holder of stock in, or a subscriber to the guaranty fund of, the bank for cooperatives shall be entitled to cast one vote. The votes shall be forwarded to the Farm Credit Administration and no vote shall be counted unless received by it within thirty days after the sending of such list of candidates. In case of a tie the Farm Credit Administration shall determine the choice. The nominations from which the list of candidates is prepared, and the votes of the respective voters, as counted, shall be tabulated and preserved and shall be subject to examination by any candidate for at least one year after the result of the election is announced.

* * * * *

[12 U.S.C. 640d, 640e, 640f.]

Farm Credit Act of 1953, c. 335, 67 Stat. 390:

* * * * *

SEC. 2. It is declared to be the policy of the Congress to encourage and facilitate increased borrower participation in the manage-

ment, control and ultimate ownership of the permanent system of agricultural credit made available through institutions operating under the supervision of the Farm Credit Administration, and the provisions of this Act shall be construed in keeping with this policy. The Federal Farm Credit Board hereinafter provided for shall within one year after appointment make recommendations to the Congress of means, supplemental to those provided by this Act, of carrying into effect such declared policy, including, but not limited to, means of increasing borrower participation in ownership of the Federal Farm Credit System to the end that the investment of the United States in the Federal intermediate credit banks, production credit corporations, Central Bank for Cooperatives, and regional banks for cooperatives may be retired.

[12 U.S.C. 636a.]

* * * *

SEC. 4 [as amended by Sec. 402, Farm Credit Act of 1955, *supra*, and Sec. 104(h), Farm Credit Act of 1959. *supra*]. (a) There shall be established, in the Farm Credit Administration, a Federal Farm Credit Board (hereinafter referred to as the "Board"). Said board shall consist of thirteen members. Twelve of the members, one from each of the farm credit districts of the United States, shall be known as appointed members and shall be appointed by the President with the advice and consent of the Senate. In making appointments to the Board the President shall have due regard to a fair representation of the public interest, the welfare of all farmers and the various types of cooperative agricultural credit interests; shall give special consideration to persons who are experienced in cooperative agricultural credit; and shall, before making such appointments, receive and consider nominations made as follows: The Federal land bank associations in the district shall designate one nominee,

the production credit associations in the district shall designate one nominee, and the cooperatives which are stockholders or subscribers to the guaranty fund of the bank for cooperatives of the district shall designate one nominee in accordance with the procedure prescribed in sections 5 (e) and 5 (f) of the Farm Credit Act of 1937 for the nomination and election of members of a district farm credit board, except that only the two persons receiving the highest number of votes shall be included in the list of nominees prepared as a result of the voting under the procedure prescribed in said section 5 (e): *Provided*, That the names of all those who are tied for second place as a result of said voting shall be included in the list; and in case of a tie in the voting under the procedure prescribed in said section 5 (f) all persons so tied shall be considered designated as nominees: *And provided further*, That if the same person would otherwise be on the list of nominees of more than one of said groups as a result of the voting under said section 5 (e) he may choose the one list on which his name shall appear, and otherwise his name shall appear only on the list of the two highest nominees of the group which gave him the highest percentage of its votes. Subsequent appointments shall be made after receiving and considering nominations made in like manner.

* * * * *

[12 U.S.C. 636c.]

Farm Credit Administration Regulations (6 C.F.R. (Rev. as of Jan. 1, 1966)):

SEC. 70.90 *General authority to determine rates of interest.*

Loans to cooperative associations made by any bank for cooperatives shall bear such rates of interest as the board of directors of the bank shall from time to time determine with the approval of the Farm Credit Administration, but in no case

shall the rate of interest exceed 6 per centum per annum on the unpaid principal of a loan (12 U.S.C. 1141f).

SEC. 70.142 Capital stock ownership required with respect to loans conforming to the Farm Credit Act of 1955; district banks.

Each borrower from a bank for cooperatives shall be required to own at the time the loan is made at least one share of class C stock. The purchase price of such stock may be retained out of the loan. In addition, each borrower as defined by the Farm Credit Administration for purposes of this sentence, shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by it to the bank during the calendar quarter. Payments for such stock shall be made quarterly or when the regular interest payments of the borrower are payable, but the stock shall be issued to the borrower as of the end of each fiscal year in the amount of the payments for stock made by it during the year. (Section 42(a)(3), Farm Credit Act of 1933, as amended; 12 U.S.C. 1134d.)

SEC. 70.162 Allocations of surplus and contingency reserves; district banks.

Net savings of a district bank for cooperatives which are placed in the surplus account or set aside as contingency reserves at the end of any fiscal year, as provided in section 36(a) of the Farm Credit Act of 1933, as amended (12 U.S.C. 1134i), shall be allocated to all farmers' cooperative associations which during any part of the fiscal year were primarily liable to the bank for the repayment of loans made by the bank pursuant to section 7 of the Agricultural Marketing Act, as amended (12 U.S.C. 1141e): *Provided, That, if the bylaws of a bank so provide, no allocation shall be made to any associa-*

tion which files with the bank prior to the beginning of a fiscal year a written refusal to accept such allocations for said year. Allocations shall be made in the proportion that the amount of interest accrued on the loans of each borrower bears to the total interest accrued on the loans of all borrowers during the fiscal year, and shall be recorded on the books of the bank as allocations for such fiscal year.

SEC. 70.165 *Same; cancellation and retirement of allocations of surplus of defaulting borrowers.*

In any case where the debt of the borrower is in default and the bank is authorized under § 70.153 to cancel and retire stock in the bank and apply the proceeds on the indebtedness, the bank may retire and cancel all or part of the allocations to the defaulting borrower in total or partial liquidation of the debt, as the case may be, but such allocations shall not be so retired and canceled until all stock of the bank owned by the borrower has been retired and canceled. All allocations of surplus to a defaulting borrower shall be retired and canceled before any allocations of contingency reserves to such borrower are retired and canceled.

SEC. 70.165a *Cancellation and retirement of stock and other equities of borrower in liquidation or dissolution.*

In the case of liquidation or dissolution of any present or former borrower from a bank for cooperatives, the bank may retire and cancel any capital stock or allocated surplus or contingency reserves or other equity interest in the bank owned by such borrower at the fair book value thereof, not exceeding par, as hereinafter indicated.

(a) The bank has reasonable assurance that the liquidation or dissolution is or soon will be completed and that the business of the borrower is not being continued in circumstances in which

it would be appropriate and feasible for the successor to acquire and hold the interests of its predecessor in the bank.

(b) The retirement of stock and other equities of any such borrower would not unduly affect the financial position of the bank.

(c) Any such retirement shall be subject to authorization as follows:

(1) Whenever the total amount of equities to be retired in any one case is \$5,000 or less the Executive or Loan Committee of the bank may approve the retirement when authorized to do so by the Board of Directors;

(2) Whenever the total amount of equities to be retired in any one case is in excess of \$5,000 but does not exceed \$25,000, retirement may be made only upon prior approval of the Board of Directors; and

(3) Whenever the total amount of equities to be retired in any one case is in excess of \$25,000, retirement may be made only upon prior approval of the Board of Directors, subject to approval of the Farm Credit Administration.

(d) At the same time, corresponding shares of stock which the regional bank was required to purchase in the Central Bank shall also be retired.

(e) A report of any retirements made hereunder showing the name of the association and the amount of separate equities retired for each shall be forwarded to the Director of Cooperative Bank Service at the end of each quarter.

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In the Supreme Court of the United States

OCTOBER TERM, 1971

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL BRIEF FOR THE UNITED STATES

ERWIN N. GRISWOLD,
Solicitor General,

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SUPPLEMENTAL BRIEF FOR THE UNITED STATES

On June 14, 1971, after we filed our opening brief in the instant case, this Court decided *Commissioner v. Lincoln Savings and Loan Assn.*, No. 544, 1970 Term, for the government. We file this supplemental brief because we believe that the decision in *Lincoln* requires a decision for the government here.

I

The issue raised in the two cases, though arising on different facts, is essentially identical. In *Lincoln*, the taxpayer, a savings and loan association, in order to obtain current insurance on its depositors' accounts,

was required by federal statute¹ both to make contributions to the Secondary Reserve of the Federal Savings and Loan Insurance Corporation ("FSLIC") and to pay regular annual insurance premiums. The latter concededly were deductible as ordinary and necessary business expenses. The taxpayer sought also to deduct the contributions as business expenses.

In the instant case, the respondent farm cooperatives, in order to fulfill their current obligations on their loans from the New Orleans Bank for Cooperatives (the "Bank"), were required by federal statute both to purchase Class C stock from the Bank and to pay the stated interest on their loans. The latter concededly is deductible as interest. They seek also to deduct the cost of the stock, in excess of a nominal value of \$1 per share, as interest, or alternatively as business expenses. Here, as in *Lincoln*, our position is that the payments in dispute result in the creation of an asset having a useful life extending substantially beyond the close of the taxable year, and that these payments are therefore nondeductible capital outlays.

II

The considerations which led this Court to conclude in *Lincoln* (slip op. 10) that the taxpayer's contributions to FSLIC's Secondary Reserve served "to create or enhance for Lincoln what is essentially a separate

¹ Section 404(b) and (d) of the National Housing Act, c. 847, 48 Stat. 1246, Title IV, as amended by Secs. 3, 4, 5 and 6 of the Act of September 8, 1961, P.L. 87-210, 75 Stat. 482 (12 U.S.C. 1727(b) and (d)).

and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature * * * are present in the instant case. They require the same conclusion with respect to respondents' contributions to the Bank's capital.

Here, as in *Lincoln*, the payments in dispute are "subject to positive and rigid continuing controls" (slip op. 10). Respondents' contributions to the Bank's capital are available only to meet losses, and only then to the extent that the Bank's current earnings, loss reserves and allocated surplus are insufficient for that purpose. Moreover, now that all of the Bank's Class A stock has been redeemed, the Class C stock (together with the Class B stock, which is available to the public) has "complete seniority with respect to demands" upon the Bank, and "is the last asset called upon" (slip op. 10).

Here, as in *Lincoln*, the contributions in question provide the contributors with "a distinct and recognized property interest" (slip op. 10). Like the interest of the taxpayer in *Lincoln* in the Secondary Reserve, respondents' interest in the Bank is transferable in limited circumstances, is refundable in cash, is evidenced by a separate account on the books of the Bank, and is "an income-producing entity" (slip op. 11) in respondents' hands.²

² We have shown in our opening brief (pp. 23-28) that the Class C stock in substance earns a return. This return is strikingly similar to the statutorily required annual credit from FSLIC's earnings to each institution's share of the Secondary Reserve (see Section 404(e) of the National Housing Act (12 U.S.C. 1727(e))), in that the return, like the

Indeed, respondents' property interest in the Bank is, if anything, even more easily identifiable than the taxpayer's interest in the Secondary Reserve in *Lincoln*. As the Court explained in *Lincoln* (slip op. 10-11), the latter interest was returnable in cash only under specified circumstances—if the taxpayer terminated its insured status, went into receivership or liquidation, or at such time as FSLIC's Primary Reserve alone reached the statutorily prescribed level. In the normal course the taxpayer's share in the Secondary Reserve would not be returned in cash, but would be used to discharge its obligation to pay regular annual insurance premiums in the future. Respondents' property interest in the Bank here, on the other hand, will be returned to them in cash in all events, save only for the remote possibility that it becomes necessary to use their shares to discharge the Bank's liabilities to its creditors.

Here, as in *Lincoln*, "the presence and significance" (slip op. 11) of the property interest has been recognized. Just as "FSLIC submits annual statements to its insured institutions showing payments and credits to their respective shares" of the Secondary Reserve

credit, becomes available to its owner only at an indefinite future time. Even if the Class C stock is viewed as earning no return, it would not be proper to treat the cost of the stock as a deductible expense rather than a capital outlay. The Court in *Lincoln* did not base its holding on the credit alone. This was only one of five factors indicating that the taxpayer had "a distinct and recognized property interest in the Secondary Reserve" (slip op. 10), which in turn was only one of the several considerations leading to the Court's ultimate conclusion.

(slip op. 11), the Bank submits annual statements to its member-borrowers showing their payments for Class C stock and their patronage dividends. Moreover, as we noted in our opening brief (p. 19 n. 14, p. 20 n. 15), the Bank has always treated the Class C stock as part of its capital, and has always treated the Class C stock it purchases from the Central Bank for Cooperatives as an asset on its books. In like manner, the Central Bank has treated the Class C stock purchased by the regional banks as part of its capital (R. 211).

It is true that, unlike the taxpayer in *Lincoln*, respondents were not subject to the accounting rules of regulatory authorities, and apparently did not record the Class C stock on their books as an asset, except to the extent of \$1 per share. But the consistent accounting treatment of the stock by the Bank and the Central Bank for Cooperatives, whose officials are most conversant with the history and purpose of the governing federal statute, is, we submit, persuasive evidence of the recognition accorded respondents' property interest in the Bank. Furthermore, the Court emphasized in *Lincoln* (slip op. 11, 14) that compulsory accounting rules do not control tax consequences, and there is thus no reason to believe that the result in *Lincoln* would have been different if the taxpayer had not booked its interest in the Secondary Reserve as an asset, as required by regulatory authorities, or if its unregulated parent corporation had not followed a similar procedure.

Finally, here as in *Lincoln*, the contributor's interest "is more permanent than temporary * * *. [and]

partakes more of the character of an asset than of an expense" (slip op. 12). The Court reached this conclusion in *Lincoln* with respect to both the taxpayer's share of the Secondary Reserve and the Federal Home Loan Bank stock which it was required to purchase (see slip op. 3), and which entitled it to borrow from its regional federal home loan bank up to 12 times the amount of its investment in the stock.³ Each, the Court said (slip op. 12), referring to the stock and to the Secondary Reserve, "is a device designed to achieve a particular and common result, namely, the providing of protection to the insured institution and to its depositors by way, in the one case, of liquidity and availability of loan funds and, in the other, by way of segregated amounts available to offset possible losses."

We have discussed in some detail in our opening brief (pp. 18-21, 28-34) what Congress set out to accomplish in enacting the Farm Credit Act of 1955, and the various long-term benefits accruing to a farm cooperative through its ownership of Class C stock. There is no need to review these aspects of the case here. It is sufficient for present purposes to point out that the Class C stock serves the same function as the Federal Home Loan Bank stock—it results in the creation of a pool of capital for the benefit of contributors to the fund. Thus, like the Federal Home Loan Bank stock, it is a device designed to provide protection to contributors "by way * * * of liquidity

³ See Section 10(c) of the Federal Home Loan Bank Act, c. 522, 47 Stat. 727, as amended by Sec. 1 of the Act of September 8, 1961, *supra* (12 U.S.C. 1430(c)).

and availability of loan funds * * *." The Court having concluded in *Lincoln* (slip op. 12) that "[c]ertainly the FHLB stock is an asset and its acquisition is capital in nature", the Class C stock too must be considered an asset whose acquisition is subject to capital treatment.*

In sum, just as in *Lincoln* (slip op. 10), "the very recital of the facts and of the structure and operation of FSLIC's Reserves * * * itself provides an answer adverse to Lincoln's argument", so here, recitation of the facts and of the structure and operation of the Banks for Cooperatives system requires rejection of respondents' claim. "And it is a matter of no consequence that respondents rely primarily on the interest provision of the Code (Section 163), rather than on the business expense provision (Section 162). Since the payments for Class C stock result in the creation or enhancement of an asset, they are not deductible under any Code provision.

* The court below held that the Class C stock had no intrinsic value; that is, that respondents derived no intangible benefit from the stock by, among other things, being able to borrow from the Bank. As the court viewed the matter, each respondent derived the full benefit of stock ownership by purchasing a single qualifying share of Class C stock, which made it eligible to borrow from the Bank. This analysis is squarely inconsistent with this Court's recognition in *Lincoln* of the permanent value of Federal Home Loan Bank stock, completely apart from any value it might have as an income-producing asset. Of course the additional shares of Class C stock had permanent value. If respondents and other farm cooperatives had not purchased the stock, then, given the government's desire to withdraw its capital from the Banks for Cooperatives system, there would have been no pool of capital and no cooperative bank from which respondents could have borrowed funds in times of need.

III

There are no significant factual differences between this case and *Lincoln* that could justify a difference in result. In each, as we have seen, the disputed payments were made under compulsion of federal statute. In each, the payor's purpose in making the disputed payments was the same as its purpose in making payments that concededly were deductible. Thus, in *Lincoln*, the taxpayer contributed to FSLIC's Secondary Reserve, and paid regular annual insurance premiums to secure current insurance on depositors' accounts; here, respondents contributed to the Bank's capital, and paid the stated interest on their loans to meet the Bank's conditions for continued borrowing. Neither in this case nor in *Lincoln* was there a market for the shares purchased. In neither case could such shares be liquidated except in unusual circumstances. The time when shares would provide a pecuniary benefit—in *Lincoln*, either in cash or in the form of future insurance coverage; here, by way of redemption—was uncertain. The shares were at all times subject to use to meet the losses of the institution in which they were held; they secured the obligations of their owners, in *Lincoln*, the taxpayer's obligations to pay regular annual insurance premiums in the future, and here, respondents' obligations to repay their loans to the Bank; and they carried with them no voting privileges whatever in *Lincoln*,⁵ and

⁵ FSLIC operates under the direction of the Federal Home Loan Bank Board whose members are appointed by the President. See Section 402(a) of the National Housing Act (12

only a single vote, regardless of the number of shares owned, in the instant case.

The court below relied on the foregoing factors in concluding that respondents' Class C stock had only nominal value, and that the cost of the stock, in excess of \$1 per share, was in substance nothing more than additional interest. These are the same factors which the taxpayer in *Lincoln* pressed upon this Court in support of its claim that its share of the Secondary Reserve was of no real value to it, and that its payments to that Reserve were essentially additional premiums for insurance on depositors' accounts. The Court found these arguments unpersuasive in *Lincoln* (see slip op. 12-14); they are no more persuasive here.

For the reasons stated, the judgment below should be reversed on the authority of *Commissioner v. Lincoln Savings and Loan Assn.*

Respectfully submitted.

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Solicitor General.

MATTHEW J. ZINN,
Assistant to the Solicitor General.

JULY 1971.

U.S.C. 1725(a)) and Section 17(a) of the Federal Home Loan Bank Act (12 U.S.C. 1437(a)).

IN THE
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UNITED STATES OF AMERICA, *Petitioner*

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL. *ℓ*

On Writ of Certiorari to the United States Court of Appeals
for the Fifth Circuit

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BRIEF AMICI CURIAE

QUESTION PRESENTED

In computing their taxable income for the years involved, are respondents entitled to deduct, as interest or as a business expense, the amounts in excess of the fair market value of Class "C" stock of the New Orleans Bank for Cooperatives which respondents were required to agree to pay for such stock during those years in order to be able to borrow from the New Orleans Bank?

INTEREST OF AMICI CURIAE

This brief amici curiae, presented in support of the respondents, is filed pursuant to written consent of the parties on behalf of Agway, Inc., a farmers' cooperative, and numerous local cooperatives affiliated with Agway, Inc. and also on behalf of M.F.A. Central Cooperative, which is also a farmers' cooperative. One of the local cooperatives in the Agway system is Penn Yan Agway Cooperative, Inc., in whose favor the United States Court of Claims has rendered a decision in a suit involving the identical question presented here (except for the fact that the suit concerned Class "C" stock of the Springfield, rather than the New Orleans, Bank for Cooperatives). *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F.2d 1372 (1969). The United States Court of Appeals for the Eighth Circuit has rendered a decision against M.F.A. Central Cooperative in a case also involving the question presented here, but with respect to the Class "C" stock of the St. Louis Bank for Cooperatives. *M.F.A. Central Cooperative v. Bookwalter*, 427 F.2d 1341 (8th Cir. 1969), *rev'g.*, 286 F. Supp. 956 (E.D. Mo. 1968), petition for certiorari pending, No. 824, this Term.

STATEMENT OF THE CASE

The facts in this case are fully set forth in the briefs of the parties.

ARGUMENT

The court below, after reviewing all the relevant facts, concluded (1) that the district court was not clearly erroneous in finding as a fact that the fair market value of Class "C" stock of the New Orleans Bank for Cooperatives was not in excess of the nomi-

nal value of \$1 per share, and (2) that the amounts in excess of such fair market value which respondents were required to pay in order to borrow from the Bank were, in reality, interest payments and were deductible as such. We shall first discuss the legal issue involved—i.e., the proper tax treatment of whatever amount in excess of fair market value of Class "C" stock the taxpayers purportedly paid for such stock. We shall then demonstrate the fallacy in the government's arguments that such stock had a fair market value equal or close to its par value.

A. Respondents Are Entitled To Deduct, Either as Interest or as Business Expense, the Amounts by Which Required Payments for Class "C" Stock Exceeded the Fair Market Value of Such Stock.

The fundamental issue in this case is the true nature of the payments which respondents were required to make, purportedly for Class "C" stock of the New Orleans Bank for Cooperatives, in order to be able to borrow money from that Bank—i.e., was the entire amount of such payments really for Class "C" stock, or was the excess over the fair market value of such stock in fact paid for the use of borrowed money?

Throughout the course of this litigation, the government has persistently refused or been unable to recognize this point and has instead apparently chosen to characterize the question as being one of whether or not the Class "C" stock is a capital asset.

We willingly concede that Class "C" stock itself is a capital asset. That fact, however, has nothing whatever to do with the outcome of this case. The question here is not the character of Class "C" stock as a capital or noncapital asset, but, rather, how much

of the \$100 ostensibly paid for a share of Class "C" stock, was in fact paid for that stock and how much was paid for the use of borrowed money. The answer to this question must be based upon a determination of the fair market value of the Class "C" stock, which was found by the district court to be no more than \$1 per share. To the extent that the total payment of \$100 per share exceeded the fair market value of the stock, it was, in reality, a payment for the only other item which the borrower acquired namely the use of money. As such, it should be fully deductible, either as interest or as a business expense.¹ The principle governing this case is as simple and fundamental as any in the tax field. In whatever context the issue arises, it is clear beyond question that when the parties to a transaction involving the purchase or exchange of two or more items of property or services allocate the total price between the items on a basis which bears no relation to the true facts, the Revenue Service and the courts will reallocate the price on the basis of the true facts.

Thus, suppose A lends money to B at a 5% interest rate but that, as part of the loan transaction, A also requires B to buy from A for \$100 a capital asset admittedly worth only \$5. Is it not clear beyond doubt that the Revenue Service would require A to include

¹ If, as a corollary, any equivalent amount must be included in the income of the Bank in years after the termination of its exempt status, the dire consequences predicted by the government (Govt. Br. p. 21, fn. 16) need not come to pass. This is so, because the Banks, if they comply with the provisions of Subchapter T of the Internal Revenue Code, which becomes applicable upon termination of their exempt status, can, through the payment of patronage refunds largely in the form of Class "C" stock, obtain an offsetting deduction.

in ordinary income, as interest, not only the 5% designated by the parties as interest, but also the \$95 representing the excess of the price for the asset over its fair market value? The answer must be "Yes." Indeed, if A contended that the \$95 should be treated as proceeds from the sale of a capital asset, the Service would not even give this contention respectful consideration. Is it not also obvious that if the excess \$95 is interest received by A, it is also interest paid by B? Again, the answer must be "Yes," since interest received by the lender and interest paid by the borrower are but two sides of the same coin. These answers are merely one manifestation of the well-established principle that the substance, rather than the form, of a transaction controls its tax consequences. Its application here can only result in a determination that no more than a small fraction of the payment purportedly made for Class "C" stock should be allocable to the acquisition of such stock, and the bulk of the payment must be allocated to the use of borrowed money, which was the only other item acquired by the taxpayer.

The government relies upon language in the Farm Credit Act to show that Congress intended payments for Class "C" stock in Banks for Cooperatives to be capital contributions and nothing more. However, as the government itself recognizes, the language of a non-tax statute cannot control the tax consequences of transactions within its scope. Though the Farm Credit Act speaks of capital structure and investment, the statute can offer no help in characterizing, for tax purposes, the payments for Class "C" stock.

It is true that under the statutory scheme the capital furnished the Banks for Cooperatives by the govern-

ment and represented by Class "A" stock was to be replaced by funds derived from the cooperative users of the Banks, whether such funds were retained earnings represented by Class "C" stock issued as patronage refunds, or whether they were payments purportedly made for the required purchases of Class "C" stock. Thus, for corporate purposes, it might be said that such amounts were "capital" of the Banks. But the fact that such funds are devoted by the Bank to the replacement of government capital has no bearing on the proper income tax treatment of the transactions giving rise to such funds. The revolving fund mechanism does not presuppose that funds used to retire government capital are, themselves, capital. This is clear from the fact that the replacement of government capital and an increase in ownership and control by cooperatives is a result which obtains regardless of the value of Class "C" stock, regardless of how much of a cooperative's payment is allocated to an investment in stock and how much is allocated to a payment for the use of money, and regardless of the outcome of this case. Those amounts paid by borrowing cooperatives, purportedly for Class "C" stock but actually for the use of money, do not lose their character as interest (or business expense) merely because the Bank uses such amounts to retire government capital. Furthermore, a finding that the Class "C" stock has only nominal value is not inconsistent with the realization of the statutory plan for retirement of government stock. The fact that, pursuant to the statutory scheme, private funds were replacing government money in the Banks, has no bearing whatever upon the tax treatment to be accorded the payment of such private funds; and, to look at the other side of the coin, the fact that the

private dollars flowing into the Bank were, for tax purposes, interest payments rather than capital investments did not diminish the number of private dollars available to replace government capital.

The Court of Claims realized this in the *Penn Yan* case, *supra*, when it stated:

"Of course, Congress considered the 15 percent surcharge on interest payable on loans as a means of providing capital to the banks for cooperatives, and the bank realistically and lawfully treated as capital, funds received in that manner. But *from the standpoint of plaintiff-taxpayer*, this was in reality an increase of the basic interest rate as an experienced cost of borrowing money from the bank, *even described in the statute and in the loan agreements as a percentage of interest payable on the loans*. Its expenditure of \$407, at least in greater part, was in reality an item of cost of conducting its business, and in the absence of compelling law to the contrary, and to the extent that it was a reasonably ascertainable cost, should be offset against plaintiff's income in the taxable year involved, in accordance with the annual accounting principle of the federal income tax laws. This is true whether such ascertainable cost is deemed interest paid under § 163 or an ordinary and necessary business expense under § 162 of the Internal Revenue Code of 1954." (Emphasis supplied.)²

² There need be no fear that this appropriate application of the annual accounting principle will result in a tax windfall to respondents. The current deduction of the amounts in issue is fully justified by the fact that respondents actually expended those amounts in the years involved and received therefor nothing of value except the use of money. If and when the Class "C" stock here involved is redeemed by the Bank, respondents will clearly realize income to the extent of the amounts previously deducted.

That Congress itself in situations like the present one does not intend characterizations of transactions in non-tax statutes to control tax consequences is demonstrated by a controversy involving the Federal National Mortgage Association (FNMA). Under its governing statute, the FNMA required mortgage sellers to purchase FNMA stock at par, such payments being characterized by the statute as "capital contributions." The FNMA stock was issued at a par value of \$100 per share, but had a market value of approximately 50% of par, and the tax treatment of the excess of the amount required to be paid for FNMA stock over the fair market value of such stock was the subject of dispute.³ In order to resolve the doubts which had given rise to this controversy, Congress added Section 162(d) to the Internal Revenue Code (P.L. 86-779, 86th Cong., 2d Sess., Sept. 14, 1960, 1960-2 C.B. 709, 713) making it clear, despite the fact that the FNMA statute spoke of "capital" and "capital contributions," that Congress had not intended that statutory language to dictate the tax consequences concerning the excess of par value of FNMA stock over its fair market value. For taxable years beginning after 1959, Section 162(d) specifically provides for the deduction of such excess in the case of required purchases of FNMA stock by mortgage sellers. The Committee Reports explaining the reasons for such treatment state:

"Taxpayer-subscribers generally have assumed that any excess of the issuance price over the

³ Compare *Ancel Green & Co.*, 38 T.C. 125 (1962), *acq.* 1963-1 C.B. 4 (see Rev. Rul. 63-44, 1963-1 C.B. 11) with *McMillan Mortgage Co.*, 36 T.C. 924 (1961), *acq. in result only*, 1963-1 C.B. 4, both of which upheld the deductibility of such excess.

market price of this stock represented an ordinary and necessary expense incurred in carrying on their trade or business since they acquired the stock in order to sell their excess supply of mortgage paper. In 1958, however, the Internal Revenue Service ruled (Rev. Rul. 58-41, 1958-1 C.B. 86) that no part of the purchase price of stock of FNMA constituted a deductible business expense. Instead, it was held that the entire amount paid for the stock must be capitalized and treated as the cost of the stock so acquired. Thus, this ruling holds that there is no tax effect at the time of the purchase or issuance of the stock even though the market price of the stock then is substantially below the issuance price. Instead, the tax effect occurs only when the stock is sold by the taxpayer.

"Your committee believes that it is unfortunate to require the capitalization of these expenditures for FNMA stock by taxpayer-subscribers to the extent they represent the excess of purchase price over market price. *Viewed from such a taxpayer's standpoint, the excess appears clearly to be expenditures which he must incur in order to sell the mortgage paper he holds.* In view of this, your committee believes that such amounts should be treated as ordinary and necessary expenses incurred in carrying on a trade or business. This, of course, means that in the transaction which occurs when the stock is sold (usually a capital transaction) the basis of the stock should not include this amount previously taken as a deduction." (H.R. Rep. No. 1662, 86th Cong., 2d Sess. 3 (1960), 1960-2 C.B. 816, 818; S. Rep. No. 1767, 86th Cong., 2d Sess. 8 (1960), 1960-2 C.B. 829, 834.) (Emphasis supplied.)

The same lack of Congressional intention to control tax consequences should be attributed to the language employed in the Farm Credit Act.

The courts have consistently held that amounts which are in fact paid for the use of money constitute interest, though in form such amounts may appear to be something other than interest and though the parties may not have called them interest. In a case involving the usury laws, for example, the Court of Appeals stated:

" The familiar doctrine is invoked that if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest and will be taken into account in determining whether the transaction is usurious. That principle is firmly rooted and we are in accord with it, . . ." (*Oil City Motor Co. v. C.I.T. Corporation*, 76 F.2d 589, 591 (10th Cir., 1935).) (Emphasis supplied.)

The government attempts to avoid the impact of this well-established rule by stating that the price which respondents and others were required to pay for Class "C" stock was not excessive. This, of course, begs the precise question on which this case turns. We show below that Class "C" stock was worth far less than \$100 per share. If that be true, payment of \$100 per share for it was "excessive." In addition, the government seeks to distinguish the usury cases by implying that their application is limited to situations involving "corrupt" agreements or "devices." The suggestion that respondents here be required to show some "crooked scheme" in order to be entitled to claim an interest or business expense deduction for the excess of what they paid over the fair market value of the Class "C" stock is totally

without merit. It has never been held that the right to allocate price on the basis of actual facts is dependent upon a showing of fraud.

The government seeks to avoid the application of this principle by relying on several cases involving simultaneous loans and stock purchases from building and loan associations. (Govt. Br. pp. 39-41.) But these cases are not apposite because in none of them did the borrower contend that the building and loan association stock required to be purchased was not in fact worth what was paid for it.

Throughout its brief, the government makes arguments which completely ignore the dual nature of the transaction here involved. It contends, for example, that respondents are not entitled to a deduction merely because they may have paid more for an asset than it was worth and that the realization of loss must therefore await the disposition or complete worthlessness of the stock. The general rule which the government states is completely sound, but it has no application to the issue in this case. The question here, which the government constantly seeks to avoid, is not what result follows when a taxpayer, in a transaction involving only the acquisition of a single item of property, pays more for that item than it is worth. Of course, in such a situation the taxpayer must wait until the property is sold or disposed of before he can deduct the loss, if any, which he has suffered. The question here is, and always has been, whether respondents in the *dual* transaction here involved, pursuant to which they acquired *both* Class "C" stock *and* the use of money, are entitled to deduct that portion of the \$100 per share purchase price purportedly paid for the Class "C" stock, which was in

substance and in fact paid not for the stock, but for the use of money.

Failure to focus on this issue caused the Eighth Circuit Court of Appeals in the *M.F.A. Central* case erroneously to reverse the district court decision in favor of the taxpayer cooperative, which was based on the ground that the \$100 per share ostensibly paid for Class "C" stock was actually paid for the use of money since the Class "C" stock had no fair market value. The Court of Appeals approached the *M.F.A.* case as though *M.F.A.*, in a transaction having no other facets or ramifications, had paid \$100 per share for Class "C" stock and had then sought a deduction on the ground that the stock was not worth the price paid for it. If that had been the case (as it would have been if, for example, *M.F.A.* had purchased the stock from another cooperative which had nothing to sell but the stock itself), the Court's decision would clearly be correct. Under such circumstances, *M.F.A.* would be entitled to no deduction unless and until it disposed of the stock for less than the \$100 per share paid for it. That would be true, irrespective of whether the Class "C" stock in the hands of *M.F.A.* was a capital asset, as the Eighth Circuit goes to great length to conclude, or a non-capital asset.

But obviously, the *M.F.A.* case, did not (just as the case at bar does not) pose the issue which the Eighth Circuit decided. *M.F.A.* was not seeking to deduct, as interest or as a business expense, any amount which was in reality paid for Class "C" stock. It is implicit in *M.F.A.*'s argument, as it is in the argument of the taxpayers in this case, and in *Penn Yan Agway Cooperative, Inc. v. United States, supra*, that any portion of the \$100 per share which could fairly

be held to have been paid for the Class "C" stock would not be deductible when paid; such amount would constitute the tax basis of the stock which would determine the profit or loss realized when the stock was disposed of. What all of these taxpayers have contended is that they should be entitled to deduct, either as interest or as a business expense, that portion of the price *purportedly* paid for this stock which was *in fact* paid, not for such stock, but rather solely for the use of money.

If the Eighth Circuit had recognized that the taxpayer was not seeking to take a loss on stock which it had purchased, but was merely seeking realistically to determine what portion of the \$100 per share was paid for such stock, and what portion was paid for the use of money, and was claiming a deduction only for the latter portion, the Court could not have fallen into the error manifested by its opinion.

The only question in *M.F.A.* as to which there could be a reasonable difference of opinion is not a question of law, but solely a question of fact—i.e., what portion of the \$100 per share was, in substance and in fact, paid for the stock and what portion was paid for the use of money? The Eighth Circuit did not believe that the record in the *M.F.A.* case justified the finding of the District Court that the Class "C" stock of the St. Louis Bank had *no* fair market value. While any precise determination of fair market value is difficult, it should be clear, for the reasons stated below with respect to the stock of the New Orleans Bank, that the Class "C" stock of the St. Louis Bank had a fair market value of no more than a small fraction of the \$100 par value purchase price. Perhaps a small percentage of the \$100 per share might realis-

tically be said to have been paid for the stock; but that would not justify the Court of Appeals in denying a deduction for that portion—clearly, the major portion—of the \$100 which was paid, not for the stock, but for the use of money. On the assumption that the stock had some small fair market value the appropriate action by the court of appeals would have been, not to reverse the district court as to the entire \$100 per share, but rather to remand the case for a finding of the precise fair market value of the Class “C” stock on the dates it was issued. Accordingly, respondents submit that the Eighth Circuit initially erred by misunderstanding the issue before it and then compounded its error by failing to follow the proper procedural disposition of the case.

The government in its Supplemental Brief argues that *Commissioner v. Lincoln Savings and Loan Association*, No. 544, 1970 Term, 39 U.S.L.W. 4726, requires a decision for the government here. We submit that *Lincoln* is clearly distinguishable from the present case. In *Lincoln* this Court held that “additional premium” payments by a state-chartered savings and loan association to the Federal Savings and Loan Insurance Corporation (FSLIC), required to be made under Section 404(d) of the National Housing Act as prepayments with respect to future premiums, were capital expenditures and not insurance premiums currently deductible as ordinary and necessary business expenses under Section 162(a) of the Internal Revenue Code. It is true that both *Lincoln* and the present case involve the same *general* issue—i.e., whether a payment is a capital expenditure or a deductible expense. But here the similarity ends. The differences in the factual patterns of the two cases, referred to

in detail in respondents' brief, are numerous and significant. The fundamental difference between the two cases is that the issue on which this case turns, i.e., the proper allocation of a payment between two items, was not presented to or considered by this Court or either of the lower courts in *Lincoln*.

The payments at issue in *Lincoln* were credited to a "Secondary Reserve," and a separate account was maintained reflecting each contributing insured institution's share of such Reserve. The statute provided for the mandatory refund in cash of an insured institution's share of the Secondary Reserve upon termination of its insured status or when the FSLIC's "Primary Reserve" reached a stated level. It further provided for the mandatory use of an institution's share of the Secondary Reserve to pay the institution's basic insurance premiums when the aggregate of the Primary and Secondary Reserves reached a specified level. The FSLIC was required to, and did, credit to each institution's balance in the Secondary Reserve an amount computed at a rate equal to the FSLIC's return on specified investments. It was found that the Section 404(d) payments created a separate and distinct income-producing asset, i.e., the payor's share in the Secondary Reserve, and accordingly did not give rise to a tax deduction.

Perhaps because of the income-producing aspect of the Secondary Reserve and its other characteristics which differ markedly from those of Class "C" stock, the taxpayer in *Lincoln* made no allegation and offered no proof that its investment in the Secondary Reserve had a fair market value less than the amount paid by the taxpayer. That taxpayer took the position that it was entitled to deduct the entire amount

paid without regard to the value of any asset created by the payment. Consequently, no court involved in the *Lincoln* litigation even considered the effect of a possible discrepancy between the amount paid by the taxpayer and the value of the asset acquired. In the present case, on the other hand, the existence of such a discrepancy is the heart of the taxpayer's case. Here the taxpayer seeks to deduct only that portion of its payment which, because it exceeds the fair market value of Class "C" stock, was in reality not paid for that asset, but rather for the use of money.

B. The Fair Market Value of the Class "C" Stock of the New Orleans Bank for Cooperatives Was No More Than a Small Fraction of the Par Value (\$100 Per Share) Which Respondents Were Required To Pay for Such Stock.

The characteristics of the Class "C" stock of the New Orleans Bank for Cooperatives purchased by respondents during the years in question lead inevitably to the conclusion that such stock could not have a fair market value anywhere near its \$100 per share par value. That stock paid no dividends and had no growth potential. It was redeemable at par, but only after the prior retirement of all Class "A" and Class "B" stock and previously issued Class "C" shares. Even then, redemption was subject to the discretion of the Board of Directors of the Bank. At the time of acquisition, the facts indicated that the Class "C" stock in question would be retired, if at all, only at some indefinite, but distant future date.⁴

⁴The government goes outside of the record (Govt. Br. p. 7) to refer to Farm Credit Administration records which purportedly show a fourteen year redemption period for the first series of Class "C" stock issued by the New Orleans Bank. Of course, the valuation issue here involved is the value of Class "C" stock at

Transferability of the shares was also restricted in that they could be sold or transferred only to another qualified farmers' cooperative with the prior authorization of the Bank's Board of Directors and the approval of the Farm Credit Administration. Finally, the Class "C" stock here involved carried no voting rights, since each shareholder was limited to one vote and this vote had been acquired in earlier years when respondents had purchased the initial qualifying share which was a prerequisite to borrowing from the Bank. No one in his right mind would have voluntarily paid more than a small fraction of par for additional shares of Class "C" stock.

The district court found that such stock had only a nominal value, not in excess of \$1 per share. We believe that the evidence supports that finding. If this Court should disagree, it should, we respectfully submit, remand the case for a new determination of fair market value. It would not be proper to reverse, as the Eighth Circuit did in *M.F.A. Central*, because whether one concludes that \$1 or \$5 or \$10 per share is the correct fair market value of the Class "C" stock here involved, it cannot be gainsaid that the fair mar-

the time it was acquired by respondents. This value must be based upon facts known or knowable at that time. When the Class "C" stock at issue was acquired, respondents had no way of knowing that redemption might be made within fourteen years. Indeed, the government's own expert witness assumed, on the basis of information available as of the end of the fiscal year 1958, the first year involved in this case, that it would take 28 years to redeem Class "C" stock issued in 1958. R. 218, 296-7. Cf. *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F.2d 1372 (Ct. Cl. 1969), in which an estimate of a thirty-year redemption period for Class "C" stock of the Springfield Bank for Cooperatives issued in 1959 was accepted by the court in the light of facts known to the taxpayer at the end of that fiscal year.

ket value of such stock was far below the \$100 per share par value which respondents were required to pay.⁵

In its brief to this Court, the government goes to great lengths in an attempt to show that the Class "C" stock was an asset having a value equivalent to the price which respondents were required to pay for such stock under their loan agreements. However, analysis of the government's contentions on this issue reveals that the characteristics emphasized in the brief have no bearing on the actual fair market value of the stock in question nor on the proper characterization of amounts purportedly paid by respondents for such stock.

For example, the government argues that the Class "C" stock has certain "intrinsic" value. In support of this contention, it cites the various financial services provided by the banks to member cooperatives and emphasizes the ultimate vesting of bank ownership and control in borrowing cooperatives as a result of the retirement of government capital (Class "A" stock) with the proceeds of required Class "C" stock purchases. Without belaboring the point that Federal tax laws are not concerned with "intrinsic" value but only with fair market value, it is clear that the factors cited by the government are irrelevant to the issue of stock value and to the proper characterization of the payments made by respondents. The right to receive financial services provided by the Banks for Cooperatives is obtained upon purchase of the initial

⁵ The government's own expert witness testified on direct examination that the stock in question had a fair market value ranging from \$3.42 to \$38.65 per share, depending upon the year of its issuance. (R. 294.)

qualifying share of Class "C" stock. Subsequent distinctions in the level of sophistication of those services as between member cooperatives depend, not upon the amount of Class "C" stock which a borrower owns, but upon the amount of business done with the bank — i.e., the amount of money borrowed. It is obvious that the financial services do not enhance the value of the stock. Respondents would be entitled to identical services even if they sold or otherwise disposed of every share of Class "C" stock which they had acquired (over and above the single qualifying share which they were required to own).

In making its determination that Class "C" stock had only nominal value, the district court correctly concluded that this stock earns no return; it pays no dividend and is entitled to no more than par value upon redemption. Nevertheless, the government would have this Court believe that Class "C" stock "in substance earns a return" on the theory that it entitles its owners to receive patronage refunds in the form of Class "C" stock. (Govt. Br. pp. 23-28; Supp. Br. p. 3.) In essence, the government argues that the receipt of patronage refunds by a cooperative in any given year is somehow dependent upon the amount of Class "C" stock required to be purchased by the cooperative during that year and that such Class "C" stock is therefore entitled to a share of the Bank's profits for that year. This argument, if not a deliberate attempt to mislead the Court, reveals a complete lack of understanding of the patronage refund system of the Banks for Cooperatives.

A cooperative borrower's share of the patronage refunds paid by a Bank in any given year is computed by comparing the amount of interest paid by that co-

operative to the total interest payments made by all borrowing cooperatives during the year. (12 U.S.C. § 11341(b), quoted at Govt. Br. p. 52.) Patronage refunds are refunds of the interest paid by the customers or patrons of the Bank. As the following discussion makes obvious, there can be no serious suggestion that patronage refunds are issued with respect to Class "C" stock purchased during the year. It is not by making required Class "C" stock purchases that a cooperative becomes entitled to receive patronage refunds, but by the act of borrowing money and paying interest to the Bank.

This becomes crystal clear when one realizes the undeniable fact that *the amount of patronage refunds to which a cooperative is entitled in any given year would not be affected in any way if the cooperative were to transfer to another cooperative, pursuant to the limited permission granted by the statute, all or any part of the transferor's Class "C" stock* (over and above its single qualifying share which entitles it to do business with the Bank) *whether such stock had been purchased or acquired as a patronage refund or as a distribution of allocated surplus in that year or any other year.* The patronage refund would still be made on the basis of the interest paid by the transferor cooperative. The amount of Class "C" stock purchased or otherwise acquired or held during the year would have no bearing whatever on the patronage refunds. Moreover, the transferee cooperative in such a situation would not be entitled to any increase in patronage refunds as a result of its acquisition of additional Class "C" stock. Finally, an increase or decrease in the amount of required Class "C" stock purchases, pursuant to the statutory pro-

vision authorizing the Banks to set the amount at from 10% to 25% of quarterly interest payments, would not result in any corresponding increase or decrease in patronage refunds. Accordingly, it is simply untrue to say that Class "C" stock earns a return in the form of patronage refunds.⁶

Furthermore, the proper tax treatment of patronage refunds in the form of Class "C" stock illustrates the fallacy in the government's effort to ascribe a substantial fair market value to purchased Class "C" stock. When Class "C" stock of a Bank (or any stock of any cooperative organization) is issued as a patronage refund, the amount to be reflected in the income of the patron receiving such stock is the "fair market value," if any, of such stock. Regs. § 1.61-5(b) (1) (iv).⁷ Any argument by the government that the Class "C" stock issued by the New Orleans Bank for Cooperatives has more than nominal value is clearly inconsistent with its failure to appeal from the decision of the district court in this case that Class "C" stock received as patronage refunds must be included in respondents' income only to the extent of \$1 per

⁶ After making its tortured argument, the government then reverses itself and concedes that Class "C" stock does not produce any investment return, when it states at page 33 of its brief:

"The primary difference between the common stock of a cooperative and that of an ordinary corporation is that common stock ownership in a cooperative does not, in and of itself, entitle one to a share in the distribution of each year's profits."

⁷ This is the rule with respect to years as to which Subchapter T of the Internal Revenue Code does not apply. Subchapter T did not apply to the Banks during the years here involved.

share.⁸ By its inaction, the government has in effect admitted that the fair market value of Class "C" stock is no more than \$1 per share. Since the Class "C" stock issued as patronage refunds and the Class "C" stock required to be purchased pursuant to the loan agreements are identical, it clearly follows that the same standard should be applied in assessing the value of this stock, regardless of how it is acquired. If receipt of a share of Class "C" stock as a patronage refund constitutes a \$1 refund of the amount paid by respondents as interest, surely the same result must follow when a share of identical stock is received for a payment which is required in order to permit the payor to borrow money. If this stock is really worth its par value, why has the government abandoned any effort to require respondents and other taxpayers to include the full par value of patronage refunds in their respective taxable incomes for the years in question?

The government seeks to explain away this glaring inconsistency by suggesting that there is some difference between accrual basis taxpayers, such as respondents, and cash basis taxpayers in the treatment of patronage refunds. (Govt. Br. p. 26, fn. 22.) The attempted distinction is specious. The governing Treasury Regulation, cited above, taxes the fair market value of stock received as a patronage refund without

⁸ Respondents had reflected in income the fair market value of \$1 per share for Class "C" stock received as patronage refunds during the years in question, in the form of a reduction of interest expense. No part of the remaining \$99 par value of such stock was reported as an income or as a reduction of interest expense. The government initially contended that respondents should have reflected in their taxable income for those years the entire par value of such patronage refund stock.

regard to whether the recipient taxpayer reports on the cash or the accrual method of accounting. Indeed, no issue of accrual could possibly be involved since there is no promise to pay and consequently no obligation on the part of the Bank. Any taxpayer receiving stock as a patronage refund is treated as receiving the equivalent of cash to the extent the stock has fair market value. The government cannot avoid the inconsistency between its failure to appeal the finding that Class "C" stock received as a patronage refund was worth only \$1 per share and its present contention that such stock is worth its full par value of \$100 per share.

In summary, no argument has been made which would justify overruling the finding of the court below that the Class "C" stock in question had only a nominal value. Even if this Court were to conclude that the district court's valuation of \$1 per share is not supported by the evidence, the proper procedure would be to remand for an appropriate determination on this issue, recognizing that the excess of purchase price over whatever is determined to be the fair market value of the stock will in substance represent a payment, not for stock, but for the use of money.

CONCLUSION

For the foregoing reasons, the decision of the court below should be affirmed.

Respectfully submitted,

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 1082 , **70-52**

UNITED STATES OF AMERICA,
Petitioner,
vs.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT

**BRIEF FOR RESPONDENT, MISSISSIPPI
CHEMICAL CORPORATION, ET AL.**

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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 1082

UNITED STATES OF AMERICA,
Petitioner,

vs.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT

**BRIEF FOR RESPONDENT, MISSISSIPPI
CHEMICAL CORPORATION AND
COASTAL CORPORATION**

QUESTION PRESENTED

Whether payments of "interest override" to the New Orleans Bank for Cooperatives (required to be made quarterly at the rate of 15 percent of the contractual interest upon loans) are deductible by the taxpayers, in whole or in part, as interest or as ordinary and necessary business expense, or whether such payments are non-deductible as money required to be paid for purchase of an income-producing entity (Class C stock) at fair market value.

STATEMENT OF THE CASE

A.

The Federal Farm Credit System and the Banks for Cooperatives

This statement corrects and supplements the "Statement of the Case" appearing in the brief for the petitioner. Although such brief refers to the history of the Agricultural Marketing Act of 1929, c. 24, 46 Stat. 11 (12 U.S.C. 1964 ed., Secs. 1141-1141j), the Farm Credit Act of 1933, c. 98, 48 Stat. 257 (12 U.S.C. 1964 ed., Secs. 1131c-1138f, and U.S.C., Sec. 1011), and the Farm Credit Act of 1955, c. 785, 69 Stat. 655 (12 U.S.C., Secs. 1134-1138) with the numerous amendments thereof, it presents an erroneous conclusion concerning the nature of the entities created by the Act.

The Banks for Cooperatives, the Production Credit Associations and the Federal Land Banks are a part of the Farm Credit Administration. The nature of a district Bank for Cooperatives, the role of Federal funds made available for which Class A stock was issued and the relationship of the issuance of Class C stock of the district Bank for Cooperatives has been totally misconceived by the petitioner. The basic control of the Federal Farm Credit Board over all entities within the Farm Credit Administration (including the Central Bank for Cooperatives, the Regional Farm Credit Boards and the Banks for Cooperatives) is stated in Title 12 U.S.C. 636b:

§. 636b. Farm Credit Administration as independent agency; location; utilization of services; control

The Farm Credit Administration shall be an independent agency in the executive branch of the Government. It shall be housed in the Department of Agriculture in

the District of Columbia, and it may, with the consent of the Secretary of Agriculture, utilize the services and facilities of the Department of Agriculture. The Federal Farm Credit Board, hereinafter provided for, shall have direction, supervision, and control of the Farm Credit Administration and of its operations and functions, as provided in sections 636a-636h, 640b, 640d, 903, 1131c(e), 1131e-1, 1134d, and 1134-1 of this title. Aug. 6, 1953, c. 335, § 3, 67 Stat. 390.

The twelve Farm Credit Districts were created by Title 12 U.S.C. 640a. Within each district there is a Federal Land Bank, a Production Credit Association, and a Bank for Cooperatives. These include the New Orleans Bank for Cooperatives, as well as the St. Louis Bank for Cooperatives and the Springfield Bank for Cooperatives, which are mentioned later. The Federal Farm Credit Board controls the district Banks for Cooperatives as stated in Title 12 U.S.C. 1134c:

§ 1134c. Lending power; custodians of collateral—*Subject to such terms and conditions as may be prescribed by the Farm Credit Administration, the banks for cooperatives are authorized* (a) to make loans to cooperative associations as defined in the Agricultural Marketing Act, as amended,

The Stipulation filed in these cases states (A 104):

49. The New Orleans Bank for Cooperatives, at all times material herein, was operated under the supervision of the Farm Credit Administration, an independent agency in the executive branch of the Government. The Farm Credit Administration was authorized by law to make rules and regulations under the Farm Credit Act of 1933 and Acts amendatory thereto. (12 U.S.C., Section 665.) Attached hereto as Exhibit 17 is an official publication of the Farm Credit Administration entitled Manual for Banks for Cooperatives (including copies of all amendments thereto through June 30, 1963), which includes regulations of

the Farm Credit Administration governing the operations of banks for cooperatives; certain statements of policy relating to their activities, various basic forms and procedures; and selected informational material assembled for convenient reference.

Thus the parallel which the petitioner attempts to draw with private banking institutions and business corporations and the purchase and ownership of stock therein is wholly incorrect and misleading.

In a publication issued by the Farm Credit Administration¹ the control of the local business of each Regional Bank for Cooperatives is described as follows:

Located at the same point in each of the 12 Farm Credit Districts are a Federal Land Bank and Federal Intermediate Credit Bank, as well as a Bank for Cooperatives.

The cooperatives owning stock in a district Bank elect two of the seven members of the district Farm Credit Board which serves as a board of directors for all three Farm Credit Banks in the district. The Production Credit Associations elect two members and the Federal Land Bank Associations elect two members to each district board. The seventh member is appointed by the Governor of the Farm Credit Administration, with the advice and consent of the Federal Farm Credit Board.

However, the cooperatives owning stock in a district bank are originally permitted to elect only one member of the seven-man board, this being increased to two members when a certain portion of the government funds have been returned by the retirement of Class A stock. *Each holder*

1. The publication "Banks for Cooperatives . . . how they Operate" issued by the Farm Credit Administration as Circular 40 on January 1, 1967, was introduced as Exhibit 18-B to the Stipulation filed herein and is described in paragraph 50 thereof (A 105, 179; R 246).

of "Class C stock" in the New Orleans Bank for Cooperatives had the right to cast only one vote for only one member of the Regional Farm Credit Board during the years 1958 through 1963, the years here involved (A 226). This limitation applied regardless of the amount of "Class C stock" owned.

B.

Nature of the Credits Upon the Books of the Bank for Cooperatives Designated As "Class C Stock"

There are four categories of credits which have been entered upon the books of the New Orleans Bank for Cooperatives designated as "Class C stock":

(1) *An initial share of stock which is purchased by a cooperative when it makes its first loan and for which it is required to pay \$100. The eligibility of the cooperative for additional loans is maintained by this share. This share of stock carries with it one vote. None of the later credits entered as "Class C stock" carry with them any voting power whatever, nor do they increase the cooperative's eligibility for loans. Here the Mississippi Chemical Corporation acquired this one "share of Class C stock" in 1956 (A 116), and Coastal Chemical Corporation acquired this one "share of Class C stock" in 1957 (A 97). They were entered on the books of each corporation in the amount of \$100. They are not involved in this suit.*

(2) *Credits entered upon the books of the Bank for Cooperatives representing payments by the taxpayers as "interest override". These credits were entered in amounts equal to 15 percent of the interest paid during each calendar quarter by the borrower. These are the only credits denominated as "Class C stock" which are involved in this litigation. They do not have any voting power nor do they increase loan eligibility.*

(3) Credits entered upon the books of the Bank for Cooperatives denominated as "patronage refunds", being a part of the "net savings" of the Bank. In each of the years involved the amounts thus entered upon the books of the Bank in the amount of \$100 a share exceeded the total amount paid by each of the taxpayers as "interest override" (A 99, 97 and A 117, 116). They are not involved in this suit.²

(4) Credits entered upon the books of the Bank for Cooperatives denominated as "allocated surplus". These entries constitute the balance of the annual "net savings" of the Bank after entry of the patronage refund credits. When the surplus account of the Bank reaches 25 percent of the total outstanding capital of the Bank, the excess may be converted into "Class C stock". They are not involved in this suit.³

Patronage refunds are declared annually in accordance with Section 36(b) of the Farm Credit Act (Br. 51-52):

Patronage Refunds.—The patronage refunds of each regional bank for cooperatives shall be paid in class C stock to borrowers, as defined by the Farm Credit Administration for the purposes of this subsection, during the fiscal year for which the refunds are declared. . . . All patronage refunds shall be paid in the proportion that the amount of interest earned on the

2. All references such as (Br. 51-52) and (Supp. Br. 1-2) are to Petitioner's original brief and supplement brief. In the brief for the United States the following appears as Note 9 on page 9: "Respondents reported \$1 per share of the patronage refunds they received as a reduction of interest expense, but did not include in income the remaining \$99 of par value of each share. In the district court, the government contended that the entire par value of each patronage refund share constituted income upon receipt. The district court decided this issue adversely to the government, and the government did not appeal."

3. The government has not contended that the "allocated surplus" constitutes income to the taxpayers.

loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year.

It was stipulated by the parties to these suits as follows (A 96, 114):

The board of directors of the New Orleans Bank for Cooperatives adopted a resolution on December 15, 1955, wherein it was provided that no certificate evidencing ownership of Class C stock in the bank should be issued (see Exhibit 10-C). *The bank has never issued Class C stock certificates.*

The credits upon the books of the Bank called "Class C stock" have the following attributes (A 93-128):

- (1) Neither dividends, interest nor any type of earnings can be paid upon "Class C stock". The so-called patronage refunds in "Class C stock" arise from and are calculated upon interest paid on outstanding loans. *The amount of Class C stock "owned" does not affect the amount of the patronage refunds credited.*
- (2) Patronage refunds are credited only to borrowers from the Bank during the year involved. Other holders of "Class C stock" receive no patronage refund.
- (3) No certificate of "Class C stock" has ever been issued by the New Orleans Bank for Cooperatives (A 96).
- (4) The New Orleans Bank for Cooperatives has *never sold* a single share of "Class C stock" except under the *compulsion* of the statute and regulations (A 242).
- (5) The shares of "Class C stock" here involved have no voting power. *The original qualifying share in each case had one vote* and was entered by each taxpayer on the basis of \$100.00 par prior

to the period here involved. This one share maintained the cooperative's eligibility for future loans. Such "share" is not involved here. Even though a borrower may own one million shares, it still has only one vote.

- (6) The "Class C stock" *may not* be retired or revolved at par until (a) all government Class A stock has been retired, (b) all Class B stock which was issued during or prior to the year in which the subject "Class C stock" was issued has been called for retirement or retired, and (c) all prior "Class C stock" has also been retired. This may be done in the discretion of (i) the Bank, (ii) the Regional Farm Credit Board, and (iii) the Federal Farm Credit Board. The contingencies affecting the exercise of such discretion are listed elsewhere (Sec. 42(a) (3), Br. 52).
- (7) The stock has no growth potential as (if it is redeemed or revolved) such redemption can only be at par, without interest. *Book value is irrelevant.*
- (8) In making a loan the Bank requires a *financial statement from the borrower and if any such statement contains "Class C stock" as an asset, the Bank will not consider it in determining whether to make the loan.* In other words, such "Class C stock" has no value as collateral either to the New Orleans Bank for Cooperatives or otherwise. However, it is subject to a lien as security for any indebtedness of the borrower to the Bank and cannot be transferred until such lien is satisfied (A 238, 246, 243).
- (9) Upon foreclosure or upon liquidation of a borrower, all other security is first exhausted. "Class C stock" is used only as a credit up to the unpaid balance. The Bank has never retired any "Class C stock" which remained to the credit of the borrower after liquidation of the debt (A 244).

The record shows that the Bank had never otherwise retired any "Class C stock" and had never revolved or redeemed any such stock (A 244).

- (10) A cooperative may not purchase "Class C stock" from another cooperative and use it in lieu of cash to pay the interest override to the New Orleans Bank for Cooperatives (A 245).
- (11) A cooperative may not pay an interest override by using in lieu of cash "Class C stock" owned by it (A 246).

When the Class A stock owned by the Government is paid in full (whether from annual net savings of the Bank for Cooperatives or with borrowed money), the only effect is to remove the inhibition against revolving of "Class C stock" because of the existence of such Class A stock. All of the above elements still exist as to "Class C stock" theretofore and thereafter issued. The concurrent exercise of the discretion of the Bank, the Regional Farm Credit Board and the Federal Farm Credit Board as to whether or not the oldest "Class C stock" shall be revolved depends upon many factors, including the following:

- (a) The variable amount of funds received from the "interest override" charged to borrowers, which may be fixed between 10% and 25%.
- (b) The varying net savings available to the Bank in the "spread" between the interest paid by it on its debentures and the interest charged by it to its borrowers.
- (c) The extent that losses may be incurred by the Bank in its operations.
- (d) Whether it is decided that the Bank shall retain the funds and expand the financial strength and resources of the Bank, rather than revolve the "Class C stock"

- (e) Taxes payable by the Bank after all Class A stock has been redeemed.
- (f) The statutory requirement that 20 percent of all current patronage refunds must be paid in cash to its current patrons, applicable when all Class A stock has been redeemed.
- (g) The joint and several liability of the New Orleans Bank for Cooperatives with all other Banks for Cooperatives on their consolidated debentures amounting to \$382,000,000 in 1961, \$429,000,000 in 1962, and \$462,000,000 in 1963.⁴

All of this brings us back to a consideration of that which resulted from the payment of cash by the taxpayer as an "interest override", followed by a credit upon the books of the New Orleans Bank for Cooperatives denominated as "Class C stock". It is inescapable that the most which can be said is that such credits are in the nature of revolving fund credits which may never be revolved and are subject to so many varying discretions and contingencies that they are of only nominal value to the borrower which made such payments for the use of money.

4. Under the statute, as well as the "Manual for Banks for Cooperatives" published by the Farm Credit Administration, the New Orleans Bank for Cooperatives is jointly and severally liable for all of the outstanding consolidated debentures of the thirteen Banks for Cooperatives. The auditor's note to the financial statement of the New Orleans Bank for Cooperatives for the year ending June 30, 1963, is as follows (A 103, R 24):

The unmatured consolidated debentures represent this bank's participation in consolidated debentures outstanding in the total amount of \$462,000,000 for which the 13 banks for cooperatives are jointly and severally liable.

The identical note appears on the statement for the fiscal years ending June 30, 1962 and June 30, 1961, with the exception that the then outstanding amount of the unmatured consolidated debentures totaled \$429,500,000 and \$382,000,000, respectively. See Exhibit 12 to the Stipulation (A 103, R 24). The original exhibit has been filed with the Court. Hence, should any one or more of the other District Banks have financial difficulties, any "redemption" of the Class C stock of the New Orleans Bank for Cooperatives would be indefinitely delayed.

SUMMARY OF ARGUMENT

A.

Section 163(a) of the Internal Revenue Code allows a deduction "for all interest paid or accrued within the taxable year". Section 162(a) allows a deduction for "ordinary and necessary expenses paid or incurred in carrying on any trade or business. . . ."

The cost of voluntary acquisition of a capital asset which has fair market value and is "an income-producing entity" with a useful life extending substantially beyond the close of the taxable year is not deductible. On the other hand, if a taxpayer is required by contract or by statute to make payments for the use of money which exceed the fair market value of the property or asset received, such excess is deductible.

"Class C stock" is not an income-producing entity or asset and its fair market value to the taxpayer is nominal. The difference between the excessive price or amount paid (\$100.00 per share) and the fair market value of the "Class C stock" (\$1.00 per share) is deductible either as interest or as an ordinary and necessary business expense.

A loss suffered upon the sale or the final disposition of a capital asset is not involved. There is involved the nature for tax purposes of the sums paid in excess of the fair market value of Class C stock.

B.

*Lincoln*⁵ did not involve a determination of the value of the deposits by the taxpayer into a Secondary Reserve (upon which interest accrued annually). The taxpayer did not raise the question of value in that case, doubt-

5. *Commissioner v. Lincoln Savings & Loan Association*, No. 544, October Term, 1970, decided by this Court on June 14, 1971.

less because the availability as cash of the principal (plus accrued annual interest) resulted in "an income-producing entity" having actual substantial cash value to the taxpayer (equivalent to fair market value). The factual differences applicable to the deposits in *Lincoln* (labeled as "prepayment of future insurance premiums") and the interest override payments here (labeled as "investment in Class C stock") are so numerous and significant that the final result reached in *Lincoln* has no application here.

Rather than requiring "a decision for the government here" (Supp. Br. 1), application of the principles announced in *Lincoln* to the facts in these cases will result in an affirmance.

The deposits in *Lincoln* (a) are subject to being withdrawn in cash at face amount plus annual interest, by the taxpayer whenever it decides to terminate its insurance with the FSLIC, (b) bear annual interest "at the rate paid upon obligations of, or guaranteed as to principal and interest by, the United States", (c) are available as cash when required to pay the annual insurance premiums and (d) the statute mandated repayment with interest upon occurrence of named events. These deposits necessarily have very substantial value.

The statutory label of the payments here as "investments in Class G stock" is not controlling. Neither the specific terminology used, the general overall provisions of the Farm Credit Act nor its legislative history change the true nature of the interest override paid here. The rule is stated in *Lincoln* (Slip Op. 14):

... so the statutory labels of "prepayment" and "additional premium" contained in § 404 (d), are not controlling.

D.

As the payments of interest override did not result in the acquisition of an "income-producing asset" having a material fair market value (comparable to the sum paid) which continues in future years, the payments by these taxpayers are governed by the rule of *Lincoln* (Slip Op. 10):

Further, the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year.

The ownership of "Class C stock" resulting from these payments resulted in no actual value or material benefit to the taxpayers except the possible revolving of the payments at some unknown and unknowable future time. Repayment is subject to the discretion of (1) the Bank for Cooperatives, (2) the District Farm Credit Board, and (3) the Federal Farm Credit Board. There is no mandatory provision, such as that existing in *Lincoln*, which requires the payments to be revolved upon the occurrence of stated events. *Repayment rests solely within the concurrent discretion of the three above entities.*

Class C stock resulting from these payments has no similarity to capital stock of a private corporation. It differs therefrom in at least eleven particulars, all material for tax purposes, as detailed above.

E.

The rule permitting deduction of excessive price required to be paid for purchase of an interest, right or property in connection with a loan applies here.

Respondents join issue with the position of the petitioner that (Br. 13):

... the price of Class C stock is not excessive; the stock earns a return and also has intrinsic value.

All Class C stock of a Bank for Cooperatives entered during any tax year is identical in nature, value and rights arising therefrom (with the exception of the initial qualifying share not here involved).

Under *Long*⁶, *Carpenter*⁷, and other cases, and under Treasury Regulations, Section 1.61-5(b) (1) (iv), patronage refunds received by a taxpayer (whether in the form of "stock" or revolving fund credits) were taxable to the recipient at fair market value during the years here involved.

By abandoning its claim that patronage refunds received by these taxpayers in identical years from the identical Bank for Cooperatives had a value of more than \$1.00 per share, the Government has admitted that such "Class C stock" credits do not have taxable value. Hence, the entry thereof at \$1.00 per share of nominal value attributed to this stock by the taxpayers was proper. The decisions of the Court of Appeals for the Fifth Circuit in these cases, of the Tax Court in *Penn Yan Agway*,⁸ and of the District Court in *M.F.A. Central Cooperative*,⁹ are correct. The cases at bar should be affirmed.

6. *Long Poultry Farms v. Commissioner*, 249 F.2d 26 (C.A. 4), decided November 8, 1957.

7. *Commissioner v. B. A. Carpenter*, 219 F.2d 635 (C.A. 5), decided March 2, 1955.

8. *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F.2d 1372.

9. *M.F.A. Central Cooperative v. Bookwalter*, 286 F.Supp. 956, reversed, 427 F.2d 1341, petition for writ of certiorari pending, No. 824, this Term.

F.

If this Court finds from the facts existing when this stock was issued as contained in the record in this case, that the "Class C stock" had a fair market value substantially in excess of that found by the District Court and the Court of Appeals this will be a reversal of a finding of the lower courts upon conflicting evidence. *Upon such finding the proper action would be that the case be reversed and remanded for a determination of such value.* This would result in a reduction of the amount deducted by the taxpayers to the extent that such value exceeds \$1.00 per share.

The position of the Government that this case should be reversed and rendered is untenable.

ARGUMENT**POINT I**

Lincoln Did Not Involve the Question of the Value for Tax Purposes of Deposits Made into the Secondary Reserve Which Earned Interest Annually and Were Available for Use As Cash. Ultimate Determination of Nondeductibility Has No Application Here Because of the Numerous and Significant Factual Differences.

The United States has filed a supplemental brief limited to a discussion of the case of *Commissioner v. Lincoln Savings & Loan Association*, No. 544, October Term, 1970, decided by this Court on June 14, 1971. Such brief states, "we believe that the decision in *Lincoln* requires a decision for the government here". For the convenience of the Court we will first discuss the impact of *Lincoln*.

Similarities Between Lincoln and the Case at Bar

Petitioner's supplemental brief states on page 1:

The issue raised in the two cases, although arising on different facts, is essentially identical.

The opposite is true. The similarities between *Lincoln* and the case at bar are:

- (a) The payment was made under a federal statute.
- (b) The terminology used in each statute did not reflect the true nature for tax purposes of the respective payments.
- (c) There were statutory restrictions upon the transfer of the deposit and of the Class C stock.

(d) Neither payment carried with it voting privileges. The above similarities are chiefly technical and had no material bearing upon the deductibility of the deposits or the payments.

At the outset we emphasize the application of two findings of this Court in *Lincoln*. First, it is immaterial that the statutory requirement to make "interest override" payments is labeled a requirement "to invest in Class C stock". In *Lincoln* this Court disregarded the statutory designation of the payment (Slip Op. 14):

We emphasize that just as compulsory accounting is not controlling tax-wise, *Old Colony Railroad Co. v. Commissioner*, supra, so the statutory labels of "prepayment" and "additional premium" contained in § 404 (d) are not controlling.

The amounts paid were entered in the books of the company under the designation "Class C stock". Similar entries were made annually of allocation of patronage refunds as "Class C stock".

The second finding in *Lincoln* which is of particular importance appears on page 10 of the Slip Opinion:

Further, the presence of an ensuing benefit that may have some future aspect is not controlling; *many expenses concededly deductible have prospective effect beyond the taxable year.*

As pointed out below, the presence of any ensuing future benefit is so illusory in the case of the payment of the "interest override" that it necessarily falls within the above rule. The factual differences detailed below clearly demonstrate the reason that a different conclusion was reached in *Lincoln* from that reached in this case by the Court of Appeals for the Fifth Circuit, in *Penn Yan Agway* by the Court of Claims, and in *M.F.A. Central Co-operatives* by the District Court.

**Differences Between Deposits into the Secondary
Reserve in Lincoln and Payments of the Interest
Override Here**

In Lincoln the deposits made into the Secondary Reserve in truth and in fact resulted in an income-producing asset. One of the material bases of the finding in Lincoln was the mandate of Section 404(e) of the Federal Home Loan Bank Act that there be credited to the Secondary Reserve annually "a return on the outstanding balances of the Secondary Reserve during such calendar year" at a rate equal to the average annual return to the Corporation (Federal Savings & Loan Insurance Corporation—"FSLIC"), "on investments held by the Corporation in obligations of, or guaranteed as to principal and interest by, the United States". This major factor was recognized by the Court in Lincoln (Slip Op. 11):

The statutorily required annual credit from FSLIC's earnings to the institution's share of the Secondary Reserve. The share thus is an *income-producing entity*, and the income inures for the benefit of the insured institution.

In this connection we quote from the brief of the United States in Lincoln (page 18):

Moreover, respondent's share of the Secondary Reserve is itself earning a return ranging from 3.15 to 4.23% annually (R 35-38, 52).

We emphasize that the "interest override" payments never earn any return or income of any nature. To the contrary, the "Class C stock" of the NOBC bears no interest, may receive no dividends, and, if the Bank, in its discretion, decides to revolve or redeem the "stock", the only amount received would be the principal sum originally paid by the borrower many years before as "interest override".

In Lincoln the taxpayer had the discretion to require at any time that the FSLIC refund the principal of all deposits plus annual interest. This major factor affecting the taxable nature of the deposits was recognized in Lincoln (Slip Op. 10-11) as follows:

The prospective refund, and in cash at that, of the institution's pro rata share upon termination of its insured status or upon receivership or liquidation or when the Primary Reserve alone reaches the suspension level.

In Lincoln this Court brushed aside the taxpayer's argument that the termination of insurance would be an undesirable business decision (Slip Op. 12-13). The legal right is fixed by the statute. Throughout the United States the deposits of many savings and loan associations are insured by companies other than the FSLIC. The writer of this brief has represented one such insuring corporation.

In the case at bar the taxpayers have no control whatsoever over the amounts paid as "interest override". Whether the resulting "Class C stock" will be revolved or refunded without interest lies solely within the discretion of the Bank. Even though the taxpayers here were to obtain their financing from some financial institution other than the Bank for Cooperatives and thereby terminate their status as borrowers (an action considered and investigated by them several times), they cannot require repayment of the sums paid as "interest override" and entered upon the books of the Bank as "Class C stock". The material factor is that the taxpayers here have no legal right to require repayment in cash at any time or under any circumstances. Repayment is solely within the discretion of the directors of the Bank for Cooperatives.

In Lincoln the statute mandated the refund in cash or the use as cash of the principal and accrued interest of all deposits upon the occurrence of events described in the statute. The FSLIC has no discretion. On the contrary, the directors of the Bank for Cooperatives may exercise their unlimited discretion in determining when and whether or not the amounts paid as "interest override" shall be repaid by redemption of the "Class C stock" upon occurrence of events described in the statute. Whether or not such sums will be credited to the borrower if it goes into liquidation or receivership is also within the sole discretion of the directors of the Bank.

Each applicable section and paragraph of the Federal Home Loan Bank Act provides that under the described circumstances the FSLIC "shall pay in cash", or the payments "shall be used" as cash, or equivalent mandatory words.

The opposite is true of the provisions of the Farm Credit Act applicable to Banks for Cooperatives. All of the provisions of the Farm Credit Act having to do with use of credited "Class C stock" in case of liquidation or receivership and in the case of retirement or revolving thereof (12 U.S.C. 1134, Sections 36 and 42 of the Farm Credit Act, as amended, see pages 49 through 58 of the brief for the United States) provide that, "The Bank may retire and cancel any capital stock or allocated surplus and contingent reserve or other equity interest", or that "Class C stock also may be retired at par by calling the oldest outstanding Class C stock".

Every action which may be taken by the Bank for Cooperatives resulting in financial benefit to the borrower lies solely within the discretion of the directors of the Bank, exercised in accordance with rules of the Farm Credit Administration.

The mandate to use as cash or to refund in cash the FSLIC deposits, upon the occurrence of stated events, cannot be equated with the discretionary use or refund of the "interest override" payments by the Banks for Cooperatives, upon the occurrence of stated events.

**No Question Was Raised or Decided in Lincoln
Concerning the Fair Market Value of Its Deposits
in the Secondary Reserve**

The supplemental brief of the petitioner states, "Our position is that the payments in dispute result in the creation of an asset having a useful life extending substantially beyond the close of the taxable year", and that, "Respondents' interest in the Bank is . . . 'an income-producing entity' in respondents' hands" (pages 2-3).

This position begs the issue in the case at bar. The present question (although falling within the ambit of what is or is not a capital asset and what is or is not deductible as payment of interest or an ordinary and necessary business expense) actually involves solely the value of the entries of "Class C stock" made by the Bank upon the payment of the "interest override". The minor prospective effect of some possible ensuing benefit beyond the taxable year was negated in *Lincoln* as a factor determining whether or not these payments are deductible. As elsewhere demonstrated, this "Class C stock" never has and never will produce any income. Redemption may never occur.

The true issue in the present case and the correct determination thereof (demonstrating that *Lincoln* does not adversely impinge upon this case) can best be clarified by quoting from the opinion of the Court of Appeals for the Fifth Circuit (A 354-356):

In the present case, considering the nature of the Class C stock and the testimony as to its value adduced in the district court, that court was not clearly erroneous in determining that the Class C shares had no fair market value and no more than a nominal value to the taxpayers. . . .

Neither did taxpayers acquire an asset of continuing value, though less than the purchase price; *the Class C shares were of no appreciable value to the taxpayers.* It is at odds with the incisive realism required in determining the tax consequences of ambiguous transactions to treat these purchases as "investments"; they were something else. (27)

We agree with the trial court and with the Court of Claims in *Penn Yan*, that the purchase price of the Class C stock (in excess of the nominal value assigned it by taxpayers) is deductible as interest in the year of purchase. Section 163(a) of the Code provides, "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The interest which is deductible under this section is defined as, "the amount one has contracted to pay for the use of borrowed money." As we have noted the Class C stock was without practical value to the taxpayers. Their only reason for acquiring the shares was as a prerequisite for continued borrowing from the Bank. . . .

Note 27—Our decision on this point appears to be at odds with that of the Eighth Circuit in *M.F.A. Central Cooperative v. Bookwalter*, 427 F.2d 1341 (8th Cir. 1970) [Nos. 19,527-19,531, June 8, 1970]. Insofar as that court's decision is not attributable to the difference in value of the St. Louis shares, we are simply unable to agree. If we concluded, as did the Eighth Circuit, that the "interest override" payments were made to acquire Class C shares as capital assets, we would agree that recognition of gain or loss must ordinarily await realization through sale

or exchange. However, we agree with the court below, that, for tax purposes, the bulk of these payments were not actually made to acquire an asset.

It is clear and indisputable that no person in his right mind would invest in "Class C stock" at \$100 per share to acquire the same as a capital asset. Whether or not the "stock" ever has any value depends upon the policies, actions and discretion of the directors of the Bank for Cooperatives. No income can be earned. No dividends can be declared. No interest can be accrued or paid. The principal may be refunded at some indefinite future time.

After studying the above differences in the payments made in *Lincoln* and the payments made here, we can see why the taxpayer in *Lincoln* failed to raise the question of value. Payments made and deposited in a Secondary Reserve (a) are subject to being withdrawn by the taxpayer whenever it may decide to terminate its insurance with the FSLIC, (b) bear annual interest "at the rate paid upon obligations, of, or guaranteed as to principal and interest by, the United States", (c) are available for use to pay the annual insurance premiums when required, and (d) will be repaid *with interest* unless the FSLIC falls into financial difficulties. These deposits must necessarily have very substantial value, indeed a value approaching the principal amount thereof.

POINT II

"Class C Stock" Had No Fair Market Value at the Time It Was Credited to the Taxpayers Either As "Investment C Stock (Interest Override)" or "Patronage Refund—Class C Stock".

The books of the New Orleans Bank for Cooperatives showed, separately as to each of these taxpayers, an entry of the purchase of a "qualifying share" of Class C stock

at \$100.00. Each year thereafter three entries were made in such books, i.e., "investment in C stock (interest override)", "patronage refund—C stock" and "patronage refund—allocated surplus" (A 123, 124). It is clear from the evidence that these credits thus entered upon the books of the Bank as Class C stock—"interest override" have no fair market value nor do they have any actual cash value to the taxpayer.

In *Stiles v. Commissioner of Internal Revenue*, 69 F.2d 951 (C.A. 5), the Court said:

The 1921 Revenue Act (42 Stat. 230), § 202(c), in the same connection uses the term "readily realizable market value". The change is significant. Under the 1926 act and subsequent acts a *reasonable interpretation of the term "fair market value" is that it is equivalent to actual cash value*. In other words, the value of the property in money to one who wishes to sell to a purchaser who wishes to buy.

The something known as "Class C stock" has no exchange value. This rule is stated by the Court of Appeals of the Tenth Circuit in *Walls v. Commissioner of Internal Revenue*, 60 F.2d 347:

In *Eisner v. Macomber*, 252 U.S. 189, 207, 40 S.Ct. 189, 64 L.Ed. 521, 9 A.L.R. 1570, the court, in determining whether a stock dividend was subject to tax as income, emphasized that *income was something of "exchangeable value" proceeding from the property (capital)*. The phrase "*fair market value*" was used in the Treasury Regulations to mean that, *if a person received "something" for his services for which there was no market and which therefore had no exchange value, that "something" could not be considered as income. . . . Therefore it did not have a value realizable in money's worth. . . . From the above cases it appears that the term "fair market value" was used in the income tax statutes to mean exchangeable value,*

for, if a person could not realize a sum of money from the sale of property received by him, it was not proper to consider it as profit.

The evidence is clear that "Class C stock" will not change hands between a willing buyer and a willing seller for any amount presently realizable in cash, neither party being under any compulsion to buy or sell. The applicable rule is stated in *Willow Terrace Development Company v. Commissioner of Internal Revenue*, 345 F.2d 933 (1965):

The standard for determining fair market value under § 1001 is well established. It is the price at which property will change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the facts. *French Dry Cleaning Co. v. Commissioner of Internal Revenue*, 5 Cir., 1934, 72 F.2d 167.

The fact that the cooperatives paid par for the "Class C stock" is no evidence of value because it was done under compulsion of the statutes, regulations and loan documents. The Bank has never sold a single share of stock to any cooperative other than under compulsion of the statutory requirement (A 242). The rule applicable to such "sales" was stated by the Court of Appeals of the Third Circuit in *Hazeltine Corporation v. Commissioner of Internal Revenue*, 89 F.2d 513, 519, as follows:

The primary evidence of the fair market value of corporate stock is what willing purchasers pay to willing sellers on the open market, even though the assets of the corporation do not reflect such values. Appeal of Edwin M. Brown, 1 B.T.A. 502; *Commissioner v. Robertson*, (C.C.A.) 75 F.2d 540, certiorari denied 295 U.S. 763, 55 S.Ct. 922, 79 L.Ed. 1705. It is true that if market sales are made under peculiar and unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, they may not furnish evidence of fair market value. *Heiner v. Crosby*, (C.C.A.) 24 F.2d 191.

See also the decision of the Court of Appeals of the Third Circuit in *Collector of Internal Revenue v. Crosby*, 24 F.2d 191, holding:

The fact of sales, in itself and without regard to the circumstances under which the sales were made, does not conclusively establish either statutory fair market price or value. *Sales made under peculiar and unusual circumstances*, such as sales of small lots, forced sales, and sales in a restricted market, may neither signify a fair market price or value, nor serve as the basis on which to determine the amount of gain derived from the sale.

The great majority of the testimony adduced before the District Judge had to do with a claim by the United States that Class C stock of the New Orleans Bank for Cooperatives had a fair market value. A Mr. O'Farrell testified at length as an expert witness for the United States (A 291-342). Mr. Verlander, President of the New Orleans Bank for Cooperatives, and a Mr. Mounger testified at length on this issue for the taxpayers (A 225-262, 262-274). The evidence of Mr. O'Farrell was destroyed on cross-examination. We will not burden this brief with a discussion thereof for the reason that such evidence has been ignored and its effect abandoned on this appeal. The conflict in this evidence was resolved by the District Judge in favor of the taxpayers.

POINT III

Nothing of Taxable Value Was Received Upon the Payment of the "Interest Override" (As Demonstrated by the Tax Status of Patronage Refunds Paid in Class C Stock). The Taxpayers Were Entitled to Deduct the Amounts Paid by Them in Excess of the Nominal Value of \$1.00 Per Share.

During the years involved in this suit (1961, 1962 and 1963 as to Mississippi Chemical Corporation and 1958 through 1963 as to Coastal Chemical Corporation), the

valuation for tax purposes of capital stock and similar certificates issued by a cooperative as patronage refunds is stated in Treasury Regulations, Section 1.61-5 (b) (iii) and (iv) as follows:

(iii) If the allocation is in the form of revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or similar documents, *the amount of the fair market value of such document at the time of its receipt by the patron. . . .* However, for purposes of this subdivision, *any document which is payable only in the discretion of the cooperative association, or which is otherwise subject to conditions beyond the control of the patron, shall be considered not to have any fair market value at the time of its receipt by the patron, unless it is clearly established to the contrary.*

(iv) If the allocation is in the form of capital stock, *the amount of the fair market value, if any, of such stock at the time of its receipt by the patron.*

The above provisions were embodied in the regulation on December 2, 1959, by issuance of T. D. 6428. Thereby the Treasury Department conformed to the decision of the Court of Appeals for the Fifth Circuit in *Commissioner v. B. A. Carpenter*, 219 F.2d 635, decided March 2, 1955, and the decision of the Court of Appeals for the Fourth Circuit in *Long Poultry Farms v. Commissioner*, 249 F.2d 26, decided November 8, 1957.

It follows that if "certificates of indebtedness . . . or other similar documents" issued as patronage refunds which are payable only in the discretion of the Bank for Cooperatives "shall be considered not to have any fair market value at the time of receipt by the patron, unless it is clearly established to the contrary", the "Class C stock" issued upon payment of "interest override" by the identical Bank at the identical time to the identical tax-

payer under the identical statute and regulations and subject to the identical discretions necessarily has no greater fair market value for tax purposes than "Class C stock" issued as patronage refunds. Both the District Court and the Court of Appeals determined that the evidence in this case established that at the time of its issuance this stock had no fair market value but only nominal value.

The leading case applicable to the question before the Court is *Carpenter*, decided by the Court of Appeals for the Fifth Circuit on March 2, 1955. In that case the Court held:

These certificates were redeemable only in the sole discretion of the directors of the cooperative, were non-interest-bearing, were junior to all debts of the cooperative, and could be redeemed only upon written approval of the Columbia Land Bank, the mortgagee of the cooperative . . .

It is abundantly clear that the taxpayer's receipt of revolving fund certificates was not equivalent of the actual receipts of cash; because the certificates had no fair market value. Furthermore, it is obvious that the funds withheld by the cooperative were not subject to the demand of the respondent. The respondent could control neither the amount of the funds that he would ultimately receive nor the time at which he might receive them. *These matters were left to the discretion of the cooperative's directors, and even the directors could not pay off the certificates without written consent of the mortgagee. Therefore, the respondent never actually or constructively received or had any right to receive anything but the certificates. . . . We are of the opinion that the certificates, when issued to the respondent, did not constitute income.*

The entries of "Class C stock" (to use the words of *Carpenter*) "were redeemable only in the sole discretion of the directors of the cooperative [Bank], were non-

interest-bearing, were junior to all debts of the cooperative, and could be redeemed only upon written approval" of the Farm Credit Administration. Although it is hardly necessary to go further, we quote Chief Judge Parker of the Fourth Circuit in *Long Poultry Farms* (which cited *Carpenter* with approval), holding as follows:

On these facts, as to which there is no dispute, we think it clear that taxpayer did not receive income as the result of the credit allotted, nor did it become entitled to receive anything which could properly be accrued as income. *All that it received was a conditional credit on the books of the cooperative, a credit which was subject to diminution if the cooperative sustained losses, was subordinated to the payment of the cooperative's debts, was not to be paid until all prior holders of credits over a nine year period had been paid in full and was to be paid only if and when the directors of the cooperative should so decide.* It is argued that under implied agreement arising out of the provisions of the bylaws taxpayer in effect received in cash the amount of the credit and reinvested it in the revolving fund of the cooperative; but this is simply to exalt fiction and ignore reality. As said by this Court in *Home Furniture Co. v. Com'r*, 4 Cir., 168 F.2d 313, "Economic realities, not legal formalities, determine tax consequences." The truth is that the taxpayer never received anything except a credit on the cooperative's books which did not entitle it to receive anything except upon the conditions above enumerated, *and only then if the directors of the cooperative should so determine. . . .*

The "Class C stock" of the New Orleans Bank for Cooperatives, at the time it was acquired by the plaintiff, had no "fair market value", "actual cash value" or "exchangeable value". The amount which plaintiffs paid for such stock was paid for one reason only—in order to permit plaintiffs to borrow money from the Bank. In return for such payment, plaintiff received nothing of taxable

value. It obtained the use of money. Accordingly, such payment is deductible as interest under I.R.C. § 163(a):

Sec. 163. INTEREST.

(a) General Rule.—There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

In the alternative, such payment is deductible as an ordinary and necessary business expense under I.R.C. § 162(a):

Sec. 162. TRADE OR BUSINESS EXPENSES.

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . .

It is clear that "interest", as that term is used in the Internal Revenue Code, is "the amount which one has contracted to pay for the use of borrowed money", *Old Colony R. Co. v. Commissioner of Internal Revenue*, 284 U.S. 552, 560 (1932), or "compensation for the use or forbearance of money", *Deputy v. duPont*, 308 U.S. 488, 498 (1940). The courts have consistently held that amounts which are in fact paid for the use of money constitute interest, though in form such amounts may appear to be something other than interest and though the parties may not have called them interest. In *Oil City Motor Co. v. C.I.T. Corporation*, 76 F.2d 589, 591, for example, the Court of Appeals for the Tenth Circuit stated:

... The familiar doctrine is invoked that if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest and will be

taken into account in determining whether the transaction is usurious. That principle is firmly rooted and we are in accord with it.

In a later case, *Memorial Gardens of Wasatch v. Everett Vinson & Assoc.*, 264 F.2d 282 (C.A. 10, 1959), the same court, after quoting this statement, said at p. 285:

No further authority need be cited in support of this universally accepted principle.

This principle—that substance rather than form will determine whether a payment is interest—is firmly embodied in the tax law. In *Wiggin Terminals, Inc. v. United States*, 36 F.2d 893 (C.A. 1, 1929), the taxpayer borrowed money and agreed to pay the lender 6 percent plus a 100 percent “bonus”. This result was accomplished, presumably in order to avoid the usury laws, by issuing stock to the lender for a temporary period and paying dividends on such stock equal to the bonus agreed upon. In holding that such dividends were deductible as interest in computing the borrower’s taxable income, the court stated at p. 898:

If it be shown that dividends paid are, according to the intent of the parties, in fact interest, and the stock on which the dividends are paid is merely held by the creditor as security, it makes no difference what the reason was for paying in that form. *The courts look to the real character of the payment, and construe the statute liberally in favor of the taxpayer.*

The Tax Court applied the same reasoning in holding that an amount paid for the use of money was deductible as interest even though designated “rent discount” by the parties, *Court Holding Co.*, 2 T.C. 531 (1943), rev’d on other grounds, 143 F.2d 823 (C.A. 5, 1944), and again in *L-R Heat Treating Co.*, 28 T.C. 894 (1957), where a premium paid to the lender was held deductible as interest

in spite of the fact that the parties did not call the premium interest and that the borrower did not treat it as interest on its books.

POINT IV

The Government Admitted in the Court of Appeals That "Class C Stock" Issued Upon Payment of the "Interest Override" Was Not an Income-Producing Entity and Did Not Appeal from the District Court's Decision That "Class C Stock" Issued As Patronage Refunds Had No Value for Tax Purposes, I.E., No Fair Market Value

We are amazed by the position taken by the petitioner on pages 22 through 28 of its original brief and pages 3 and 4 of its supplemental brief. On page 24 of the petitioner's original brief the following statement is made:

When a borrower cooperative purchases Class C stock, thus fulfilling its obligation under its loan agreement (R 127), it becomes entitled to share in the distribution of the Bank's net savings at the end of the fiscal year.

On the same page this conclusion is applied to the Mississippi Chemical Corporation and upon assumption of various possible "retirement periods", it is stated to this Court that:

This represents an average annual return on its investment of 6.16 percent. If the redemption period were ten years, the average annual return would be 9.38 percent; if it were as long as 30 years, the return would be 3.03 percent.

On pages 3 and 4 of its supplemental brief petitioner states that the Class C stock received upon payment of the interest override "is an income-producing entity", referring to pages 23-24 of the original brief.

We have examined briefs filed by the United States in *Penn Yan Agway*, in *M.F.A. Central Cooperative* and

in the District Court and the Court of Appeals in the case at bar. *The United States has never before advanced the specious and untenable argument summarized in the above quotations and detailed on pages 23 to 28 of its original brief and pages 3 and 4 of its supplemental brief.*

In the brief filed for the United States in the Court Appeals of the Fifth Circuit, it time and time again recognized that "Class C Stock" is not an income-producing entity, pays no dividends, bears no interest and receives no return. The attributes of this stock are detailed on pages 5 and 6 of such brief as follows:

The taxpayers purchased Class C stock in the Bank at \$100 per share. As cooperative borrowers, they were required to invest in the Bank's stock. The stock did not pay cash dividends and could be transferred only to other cooperatives with the Bank's permission. The owners of Class C stock did have voting rights in the Bank and were entitled to a number of long-term services by virtue of their ownership interests. The precise point at which the Class C stock would be redeemed was not definite. Nevertheless, it was apparent that it would be redeemed at its full par value of \$100 per share.

After discussing the format of the Farm Credit Act of 1955, the following statement is made on page 20 of such brief:

The result was that taxpayers herein obtained Class C stock certificates which (a) *paid no dividends*, (b) were based upon the "one man-one vote" concept regardless of the number of shares owned, (c) *did not have a "market" in the usual sense*, (d) were to be retired seriatim on a revolving-fund basis, and, most importantly (e) served as a basis of the capital structure of the Banks without which they could not function.

This position is reaffirmed and explained by the Government on page 21 and page 24 of such brief as follows:

P.21—As we have shown, this type of capitalization, although peculiar to ordinary corporations, is common to cooperatives. The restrictions on transfers of the stock, *and the fact that there were no cash dividends*, are not unusual in these circumstances and are not regnant to its capital status. The substance of the stock affirms that status.

P.24—*In truth, because of the special characteristics of the stock, there is no reasonable and determinable market value which can be assigned to it. As one authority puts it (Packel, supra, p. 234):*

The circumstances surrounding the issuance of revolving fund certificates are often such that no particular market value can be ascribed to the certificate even though it refers to a sum certain.

Evidently, at this appellate level, the Government has realized that if it recognizes the facts which exist and which it admitted in the District Court and the Court of Appeals for the Fifth Circuit, in the Tax Court in *Pen Yan Agway*, and in the District Court and the Court of Appeals for the Eighth Circuit in *M.F.A. Central Cooperative*, the cases at bar will be affirmed. Hence, it has completely reversed its position and now says that patronage refunds (paid from the entire net savings of the Bank for Cooperatives in that proportion which the interest paid by a borrower bears to the total interest received) constitute a return upon the "interest override".

No share of "Class C stock" involved in this litigation carried with it voting rights, no share bore interest, received dividends, or any earning or return, no share could be used as collateral for any loan nor for any other beneficial purpose (and had no fair market value even for

sale to entities to which it might be transferred). Its only attribute is the possibility that, subject to all of the matters set forth above, at some future date (which might be 14 years, 20 years, 30 years, or 12 years), the holder of the stock may receive the number of dollars paid the Bank many years before.

Nevertheless, this stock is erroneously described in petitioner's brief as:

"an asset—an item of value—having a useful life extending substantially beyond the close of the taxable year" (Br. 9);

"an income-producing asset providing benefits in future years" (Br. 11);

"stock [which] earns a return and also has intrinsic value" (Br. 13);

"provides purchasers with long-term benefits in the form of a return on their investment" (Br. 23);

the holder "becomes entitled to share in the distribution of the bank's net savings at the end of the fiscal year" (Br. 24); and

"investment (which) grows in value through the mere passage of time, and thus produces a return to the stockholder" (Br. 27);

"purchasers of Class C stock have the opportunity to earn a return on the funds they invest" (Br. 28);

a stock which "like the stock of an ordinary corporation has continuing value" (Br. 34);

a stock which "bears a return and also has an intrinsic value" (Br. 38);

A capital asset which "is 'an income-producing entity' (slip op. 11) in respondents hands" (Sup. Br. 3)—the reference is to the slip opinion in *Lincoln*.

A simple illustration suffices to destroy the tortured argument of petitioner upon which the above conclusions rest. Let us assume that Cooperative A has accumulated Class C stock with a total par value of \$100,000 and Cooperative B has accumulated Class C stock with a total par value of \$25,000. During the succeeding year, Cooperative A borrows \$30,000 from the Bank and Cooperative B borrows \$60,000 from the Bank. As the interest paid by Cooperative A is one-half of the interest paid by Cooperative B, the patronage refunds and allocated surplus received by Cooperative A for that year would be one-half of the patronage refunds and allocated surplus received by Cooperative B for that year.

Let us assume that Cooperative X owns one qualifying share of Class C stock in the Bank (the year being its first year as a borrower) and Cooperative Y has accumulated Class C stock in the Bank during prior years with a total par value of \$150,000. Cooperatives X and Y each borrow the same amount from the Bank during the year. Each will receive a patronage refund and allocated surplus in an identical amount. Neither the ownership of Class C stock during prior years nor the "purchase" of Class C stock by payment of the "interest override" results in any income, dividend, or earning to the borrower. This is received solely because of the contractual interest paid by the cooperative during the year "in the proportion that the amount of interest earned on loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year".

Petitioner has realized that the decision of the Court of Appeals below must be affirmed unless this Court holds that these payments of interest override resulted in the acquisition of an income-producing capital asset or "an income-producing entity", having a substantial continuing

value for which the taxpayers were not required to pay an excessive price. Thus the real issue here is the value of the shares of "Class C stock" purchased under the compulsion of the federal statute.

We close this phase of the argument by referring to page 38 of petitioner's brief where it cites *Penn. Yan Agway*, (417 F.2d at 1379) opinions by the Tenth Circuit (*Oil City Motor Co. v. C.I.T. Corp.*, 76 F.2d 589, 591, and *Memorial Gardens of Wasatch, Inc. v. Everett Vinson & Associates*, 264 F.2d 282, 285), and then quotes from *Memorial Gardens* the well-recognized rule:

... if as a condition to the making of a loan at an apparently permissible rate of interest, the lender requires the borrower to sell property to him at less than its value or to purchase property from him at an excessive price, the difference represents interest and will be taken into account in determining whether the transaction is usurious. * * *

The petitioner then, brushing aside this principle of law which actually requires, of itself, the affirmance of these cases, says (Br. 38):

But this principle has no application here because the Banks for Cooperatives do not require their members to "purchase property from * * * [them] at an excessive price."

This squarely raises the basic issue of value. It is an indirect admission that if the taxpayers were required to "purchase" the Class C stock" for a price in excess of its fair market value, such excess represents interest and is deductible.

In closing we will not attempt to comment upon numerous statements in petitioner's brief which are based upon matters occurring not only long after 1963, the last year involved in these cases, but long after the trial in

the District Court. It goes without saying that statements in the brief concerning what the writer may have been told by the Farm Credit Administration, particularly as to matters occurring after 1963, are wholly incompetent and immaterial. The status and value of the "Class C stock" here involved can only be determined as of the date it was issued.

The Court will note (A 93-123) that all facts contained in the Stipulation and also that all evidence contained in the Appendix have to do with matters occurring during or prior to the year 1963. We will point out, however, that the evidence to which reference is made in Note 17 on page 22 of petitioner's brief has been misunderstood. The transfers to which reference is made (A 107, 275-291) do not reflect any consideration paid by the transferee, doubtless due to the fact that such transfer was a part of a broad transaction between the parties. The only transfer as to which consideration is recited is that from Associated Cooperatives to Mississippi Federated Cooperatives (A 276-291). This was an integral part of a complicated transaction between two related cooperatives. Mr. McNeil was the manager of M.F.C. and a director in Associated Cooperatives (A 277). There was involved the balancing of indebtednesses between the cooperatives and the \$12,000 mentioned simply was one of the belated acts balancing accounts between them.

Further, the statement that "the Bank also redeemed Class C stock for full book value on ten occasions during the years in issue" (A. 130, 133, 241; A 45-46, 238-239, 248-249) is a misunderstanding of the facts reflected in the Appendix. The transactions to which reference is made were chiefly those in which there was a foreclosure or liquidation and the book value of the Class C stock was credited to the balance due on the indebtedness but no

redemption was had of any remaining Class C stock. In other words, Class C stock was not retired or redeemed with the par value or book value thereof being paid to the stockholder. These transactions amounted to a book entry crediting the par value or book value of the stock to the indebtedness up to but not to exceed the balance unpaid.

The New Orleans Bank for Cooperatives had never revolved or redeemed any "Class C stock" at the time of the trial of these cases on November 7, 1968 (A 244).

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1971

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT**

REPLY BRIEF FOR THE UNITED STATES

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Solicitor General,

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In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-52

UNITED STATES OF AMERICA, PETITIONER

v.

MISSISSIPPI CHEMICAL CORPORATION, ET AL.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT**

REPLY BRIEF FOR THE UNITED STATES

1. Respondents and *amici* rest virtually their entire case on the proposition that the tax law permits a borrower to deduct as interest the excess of the cost of an asset acquired as a condition to a loan over the "fair market value" of the asset at the time of acquisition (Br. 21-32; *Amici* Br. 3-5; 11-16). There is no such rule of law, as a simple illustration will demonstrate. Assume that a commercial bank makes a loan of \$10,000 for ten years at a stated annual interest rate of eight percent, but, as is common with commercial loans, requires the borrower to maintain a compensating balance of \$1,000 in its checking account throughout the term of the loan. Assume further that the "present

value" of the right to receive \$1,000 in ten years is \$650. The "fair market value" of the compensating balance may be approximately zero, since there may be little or no market for restricted compensating balances. Certainly it is no more than \$650. But regardless of "fair market value," it is clear that the borrower may deduct only the stated interest on the loan, \$800, during the first year of the loan.¹

The borrower is not entitled to a \$1,000 interest or business expense deduction (assuming the compensating balance has no "fair market value") because it has not suffered a diminution of capital, but has merely converted its capital from one form of asset into another. Nor is the borrower entitled to deduct the \$350 it might have earned over the term of the loan had it been free to invest its money at the going rate of interest, rather than in a non-interest bearing checking account. The \$350 is not deductible interest or business expense. It is simply income that might have been, but was not, earned. And this Court held long ago in *Hort v. Commissioner*, 313 U.S. 28—what could hardly be controverted if stated explicitly and directly—that failure to earn income does not give rise to a deduction from income that was earned. As the Court explained (*id.* at 32-33), "[n]othing in [the statute] * * * indicates that Congress intended to allow petitioner to reduce

¹ The result would be the same if, instead of being required to maintain a compensating balance of \$1,000, the borrower were required to purchase from the bank a non-transferable, non-interest bearing certificate of deposit. The illustration in the text therefore cannot be differentiated on the ground that the borrower did not acquire an asset as a condition to the loan.

ordinary income actually received and reported by the amount of income he failed to realize."

The issue in this case thus has nothing to do with the "fair market value" or the "present value" of Class C stock at the time of its acquisition or at any other time. Respondents are entitled to a current deduction only if they suffered a diminution of capital when they purchased Class C stock; they are not entitled to a deduction if they merely converted their capital from one form of asset into another.² On this issue, *Commissioner v. Lincoln Savings & Loan Assn.*, 403 U.S. 345, is controlling. It sets forth the criteria to be applied in determining whether, in a forced investment situation, the investor has suffered a diminution of capital, and holds on virtually identical facts that the investor has merely converted its capital from one form of asset into another. No more is necessary to dispose of this case.

Respondents cannot escape the conclusion that *Lincoln* controls on the ground that it did not involve "the proper allocation of a payment between two items" (*Amici* Br. 15) or "the effect of a possible discrepancy

² Respondents and *amici* devote substantial portions of their briefs to a showing that Class C stock has no "fair market value," and contend that the government's failure to appeal from the determination of the district court that respondents realized no income upon the receipt of Class C stock patronage dividends is inconsistent with its position here (Br. 23-39; *Amici* Br. 16-23). But, as shown above, "fair market value" is not controlling on the issue before this Court. Nor is there any inconsistency with the government's failure to appeal on the question when patronage dividends are to be taken into income. Under the cases and regulations respondents and *amici* have cited, that question, unlike the one to be decided, turns on "fair market value."

between the amount paid by the taxpayer and the value of the asset acquired" (*Amici* Br. 16). The issue decided in *Lincoln* was the proper allocation of the taxpayer's contribution to the Secondary Reserve between the cost of current insurance and the cost of an asset. The effect of a possible discrepancy between the amount paid into the Secondary Reserve and the value of the taxpayer's interest therein was indeed considered, the taxpayer contending (Br. in Opp., No. 544, 1970 Term, p. 14) that the money it pays into that reserve is "[i]n truth and substance * * * gone in the year in which it is paid * * *." This is identical to the contention here (*Amici* Br. 7, n. 2) that when respondents purchased Class C stock they "received therefor nothing of value except the use of money."

The distinction between the position of the taxpayer in *Lincoln* and that of respondents here is, in sum, only verbal. The taxpayer in *Lincoln* argued that since what it purchased had little or no value, it was not an asset; respondents argue that although they purchased an asset, it had little or no value.³

2. Respondents attempt on three grounds to differentiate *Lincoln* from the present case on its facts (Br. 18-21). None of these arguments has merit.

³ *Amici* "willingly concede" (*Amici* Br. 3) that Class C stock constitutes a capital asset. This concession is hardly worthy of the name. Under *amici's* theory of the case, respondents are entitled to deduct currently, either as interest or as business expense, \$99 of the cost of each share of Class C stock purchased (\$100). Upon redemption of the purchased stock, respondents presumably would contend that they are entitled to treat the \$99 gain on each share as capital gain. There is thus the potential of a tax windfall—the tradeoff of current ordinary deductions for future capital gain—despite *amici's* assurance to the contrary (*Amici* Br. 7, n. 2).

a. Respondents first maintain (Br. 18) that whereas the taxpayer's interest in the Secondary Reserve in *Lincoln* constituted an income-producing asset, the Class C stock they are required to purchase does not in substance bear a return. But the opinion in *Lincoln* itself makes clear that the interest-bearing feature of the Secondary Reserve was not critical to disposition of that case. Nor is it essential to the government's position here. As the illustration concerning the commercial bank loan shows, it is enough that Class C stock constitutes an asset, and that respondents suffered no diminution of capital in acquiring it.⁴

⁴ The return which respondents in substance earn on Class C stock demonstrates beyond question, however, that its cost cannot be properly treated as a current expense on the theory that it provides no substantial future benefit. *Amici* deny that patronage dividends are in effect issued with respect to Class C stock purchased during the year. They rely on "the undeniable fact" (*Amici* Br. 20) that the amount of a cooperative's patronage dividend would remain the same even if it were to transfer purchased stock in the year of its acquisition. But since transfers of stock may normally be made only in connection with mergers and similar transactions between cooperatives, there would appear to be little more than a theoretical possibility that a transfer of purchased stock would be effected without a contemporaneous transfer of the rights to the related patronage dividends. Moreover, given the purpose of the stock purchase requirement—to vest ownership of each bank in the hands of those who borrow from it—the date of purchase is properly considered the date of record in determining entitlement to patronage dividends. Thus, even assuming that purchased stock would be transferred without the rights to the related patronage dividends, this does not mean that purchased stock bears no return, but rather that the stock was transferred "ex-dividends." *Amici* likewise are incorrect in their assertion (*Amici* Br. 20-21) that an increase or decrease in the stock purchase requirement would not affect the amount of patronage dividends. Such a change would usually result in a similar change in the amount of such dividends, since the Bank would have more or less money to lend

b. The legal right of the taxpayer in *Lincoln* to obtain its share of the Secondary Reserve in cash by cancelling its FSLIC insurance provides no real basis for differentiating the instant case. The proof in *Lincoln* was that the taxpayer, a state-chartered savings and loan association, would be forced to go out of business if it cancelled such insurance. The Court did not brush this argument aside, as respondents would have it (Br. 19). It recognized that the taxpayer could not, as a practical matter, convert its share of the Secondary Reserve into cash and remain in business, but held nevertheless that its contributions to that reserve were not currently deductible. Moreover, federally chartered savings and loan associations, to which the decision in *Lincoln* also applies, are required by statute (12 U.S.C. 1726) to insure their depositors' accounts with FSLIC, and thus are legally barred from obtaining refund of their share of the Reserve in cash unless they go out of business. The critical point, which respondents fail to recognize, is that an investor's capital is not diminished, and he is therefore not entitled to a current deduction, merely because he is forced to make an investment and cannot liquidate it. That point is common to *Lincoln* and the present case.

c. For similar reasons, respondents' contention (Br. 20-21) that *Lincoln* is inapposite because the Board of Directors of the Bank has discretion not to redeem Class C stock when it becomes eligible for redemption

or otherwise invest, and its income would thereby be affected. Even if the amount of patronage dividends remained unchanged, however, this would signify only that the rate of return on investment had increased or decreased, not that there was no return.

is likewise unpersuasive. So long as the investor has the opportunity to recover his original capital contribution, no portion of that contribution may be treated as interest or business expense.

The suggestion that the Board would not redeem Class C stock at all is, in any event, unwarranted. The basic purposes of the Banks for Cooperatives system are to provide credit to farm cooperatives and to allow those who borrow from a cooperative bank to own it. These purposes can be accomplished only through the orderly redemption of Class C stock. While it is possible that a cooperative bank will suffer financial reverses, and for that reason be unable to revolve its stock, this risk provides no greater basis for a deduction than it would in the case of an investment in the stock of any commercial enterprise.

Respectfully submitted.

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OCTOBER 1971.

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MISSISSIPPI CHEMICAL CORPORATION, ET AL.

On Writ of Certiorari to the United States Court of Appeals
for the Fifth Circuit

**REPLY BRIEF FOR RESPONDENT,
MISSISSIPPI CHEMICAL CORPORATION, ET AL.**

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1. Respondents have relied in this case upon the proposition that when a borrower is required, as a condition to a loan, to purchase an asset from the lender for a price in excess of its fair market value, such excess is in substance interest, and is deductible as such. This proposition is, we submit, fully supported by the usury cases cited in respondents' brief and by the well-established rule of "substance over form."

Nevertheless, the government argues in its reply brief that there is no such rule of law as that contended for by respondent. In support of its argument, the government uses the illustration of a person who borrows \$10,000 from a bank at 8% interest and who is required to maintain a \$1,000 compensating balance in a checking account with the bank throughout the term of the loan, or is required to purchase from the bank a non-transferable, non-interest-bearing \$1,000 certificate of deposit. The government argues that the borrower in this illustration is entitled to deduct only \$800 per annum as interest; that he is not entitled to deduct the interest which his \$1,000 might have earned over the term of the loan had he been free to invest it at the going rate of interest.

We agree, of course, with the government that the borrower in this illustration is entitled to no additional deduction by reason of the compensating balance or the certificate of deposit which he is required to maintain or to acquire. However, the obvious reason is that *in substance* the compensating balance or the certificate of deposit merely serves to reduce the amount which the borrower has borrowed. Instead of borrowing \$10,000, he has, in reality, borrowed \$9,000; and this is true whether the bank holds back \$1,000 or whether the borrower initially receives the full \$10,000, but then returns \$1,000 to the bank to be placed in a non-interest-bearing account or to acquire a non-interest-bearing certificate of deposit. Accordingly, the borrower's \$800 of interest represents an effective rate of 8.9% per annum on the amount borrowed, but it does not change the dollar amount of the interest paid. In other words, the compensating balance (or the certificate of deposit) in the government's illustration is nothing more than

an offset which reduces the amount loaned and which therefore increases the *rate* of interest, but which does not increase the *dollar amount* of the interest. The borrower will have had the use of only \$9,000 for the term of the loan, but at the end of the term, he can be out-of-pocket no more than the \$800 of stated interest.

The instant case bears no resemblance to the government's illustration. Here a sum of money was borrowed for a period of years and each time the borrower made an interest payment of \$100 he was required to pay not only the \$100, but also an additional \$15, ostensibly for a substantially worthless share of Class "C" stock. In fact, all except a small fraction of the \$15 was paid to secure the use of money and therefore should be deductible as interest. It would be pure fiction in this case to say that any part of the \$15 reduced the amount of loans outstanding.

2. Respondents have pointed out that the *Lincoln* case, on which the government so heavily relies, bears no relation to the present case. *Lincoln* clearly did not involve any question of the proper allocation of a single payment between two items, whereas that is all that is involved in the present case. The parties in *Lincoln* asked this Court to decide on an all-or-nothing basis whether the taxpayer's payment into the Secondary Reserve of the FSLIC was deductible in the year paid. No question of the fair market value of *Lincoln's* interest in the Secondary Reserve was raised, and no evidence of value was presented.* The taxpayer con-

* In an effort to deny this, the government points to a statement in the taxpayer's brief in the *Lincoln* case that the money which it paid into the Secondary Reserve was "in truth and substance . . . gone in the year in which it is paid . . ." This is far from a contention that *Lincoln's* interest in the Secondary Reserve had a fair market value substantially less than the amount paid.

tended that the entire amount was deductible in the year paid since it was required to be paid in that year in order to secure insurance for that year, whereas the government contended that the entire payment created an asset and was, therefore, capital in nature. Consequently, in *Lincoln*, the only question to which this Court addressed itself was whether the payment by the taxpayer was currently deductible or was a capital expenditure. Finding that the payment served to create an asset, the Court concluded that the payment was a capital expenditure and not a deductible expense in the year paid and that it would be deductible, if at all, only when used to satisfy obligations of the payor for insurance premiums in future years or to help pay unexpected catastrophic losses. There is certainly nothing in the *Lincoln* case to suggest that if it had been proved there, as it has been proved here, that the amount paid far exceeded the fair market value of the asset acquired, the Court would have denied the deductibility of the excess.

3. Though it maintains in its reply brief that the fair market value of Class "C" stock is immaterial (Pet. Rep. Br. 3), the government seems uneasy (as it should be) with this position. Otherwise, we submit, it would not continue its specious arguments that Class "C" stock "in substance earns a return." *Amici* demonstrated the falsity of this contention (*Amici* Br. 20 et seq.) by pointing out that the patronage dividends received by a borrowing cooperative would remain the same whether or not the cooperative sold to another cooperative all of the Class "C" stock which the transferor had been required to purchase from the Bank; and by pointing out that the patronage dividends of the transferee cooperative would not be increased one

dime as a result of the transfer to it of such Class "C" stock. The argument that Class "C" stock is an income-producing asset is pure sophistry. The fact is that *all* patronage dividends, whether attributable to the period before or after the transfer of the stock, will be paid to the transferor and transferee cooperatives, not on the basis of the Class "C" stock owned by each, but on the basis of the interest paid by each.

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U. S. SUPREME COURT

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REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

Respondents attempt to deny the conflict between the decision below and *Penn Yan Agway Cooperative, Inc. v. United States*, 417 F. 2d 1372 (Ct. Cl.), on the one hand, and *M.F.A. Central Cooperative v. Bookwalter*, 427 F. 2d 1341 (C.A. 8), petition for a writ of certiorari pending, No. 824, this Term, on the other, which we acknowledged in our memorandum in *M.F.A.*, and asserted in our petition here.

I

This is precisely the opposite of the position taken by the respondents in their brief in the Fifth Circuit, which was filed before the Eighth Circuit reversed the

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district court in *M.F.A.* The respondents there pointed out (p. 38) that the "legal principles involved" in the three cases were "identical." They are no less identical now.

II

In any event, the fact that there is a conflict between the lower courts is not affected by factual distinctions relating to the value of the Class C stock involved in each of the cases, as respondents now contend. The distinctions they suggest are without substance.

(1) Respondents note the finding in *M.F.A.* (Br. 6) that the stock there had "substantial value" while the *Mississippi Chemical* opinion (Br. 8) observed that the stock there was "without any appreciable market value", and in *Penn Yan Agway* (Br. 5) the court said that "there was no market for such stock." In doing so, respondents misconceive the nature of the differences between the lower courts on this point. These factual differences do not affect the underlying legal issue. That issue does not involve the market value of the stock, but turns on the legal effect of the "intrinsic value" of the stock—"its value as a capital contribution to a cooperative under the plan of the Congress" (Br. App. 53)—in determining the character of the stock for tax purposes. In *M.F.A.* the Eighth Circuit considered intrinsic value and concluded that the stock had substantial value. In *Mississippi Chemical* and *Penn Yan Agway* the Fifth Circuit and the Court of Claims refused to consider intrinsic value and concluded that the stock had only nominal value.

(2) Respondents state (Br. 7) that there was some evidence in the *M.F.A.* record of transactions indicating that the Class C stock there could be freely transferred by the cooperatives, while there is no comparable evidence in the record in the instant case. But the record here shows that on three occasions, from September, 1959, to June, 1963, Class C stock of the New Orleans Bank was transferred from one cooperative to another (R. 250).

(3) Respondents also urge (Br. 9-10) that the Class C stock in *M.F.A.* was being revolved over a shorter period than the Class C stock in this case. They note a reduction in the St. Louis bank's Class A stock from \$10,457,000 in 1956 to zero in 1967. The reduction in the New Orleans bank's Class A stock is represented as \$6,928,100 in 1956 to \$4,880,000 in 1963. Though this is accurate, it is misleading. The time periods are not comparable. Actually, the 1967 annual report of the St. Louis bank introduced in the *M.F.A.* case shows that the Class A stock of the St. Louis bank declined from \$10.4 million in 1956 to \$4.2 million in 1963. While the present record does not indicate precisely when the government's investment in the New Orleans bank will be retired, thus rendering that bank's Class C stock eligible for redemption, Exhibit W in the *M.F.A.* record states (p. 2):

The St. Louis Bank for Cooperatives was the fifth district Bank for Cooperatives to repay all of its Government capital in full. *It is anticipated that the other seven district banks, as well as the Central Bank for Cooperatives, will*

have accomplished the retirement of the Government's investment in their banks by 1971. [Emphasis added.]

The slight differences in the rates at which the funds are revolving are insignificant.

III

In sum, the distinctions suggested by respondents are distinctions without a difference, as they themselves contended when they briefed this case in the court of appeals. The critical facts in all of the cases are (1) that the taxpayers purchased the Class C stock of federally created regional banks for cooperatives in connection with loans secured from those institutions, and (2) that the characteristics of that stock and the rights and obligations of its owners flow from a capital structure prescribed by federal statute and uniform for all regional banks. These facts make indistinguishable the basic issue involved in all of the cases.

Respectfully submitted.

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JANUARY 1971

UNITED STATES *v.* MISSISSIPPI CHEMICAL
CORP. ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR
THE FIFTH CIRCUIT

No. 70-52. Argued January 10, 1972—Decided March 6, 1972

Respondent taxpayers are cooperative associations within the meaning of the Agricultural Marketing Act, and thus qualify for membership in one of the Banks for Cooperatives established by the Farm Credit Act of 1933, which provides that members may borrow money from their Banks. Respondents secured membership in the New Orleans Bank and elected to borrow. They were required by the Farm Credit Act of 1955 to make quarterly purchases of \$100 par value Class C stock of the Bank equal to not less than 10% nor more than 25% of the amount of the quarterly interest paid to the Bank on their loans. During the relevant period the rate set by the Bank was 15%. Respondents claimed a \$99 interest expense deduction on their tax returns for each \$100 stock purchase required by the statute. The deductions were disallowed and respondents filed this suit for refunds. The Government contended that the stock is a capital asset as defined by 26 U. S. C. § 1221, and is nondeductible, while respondents asserted that the purchase price is part of "the amount [they] contracted to pay for the use of the borrowed money," and is deductible as interest. The District Court found for the respondents and the Court of Appeals affirmed. *Held*: It is clear from the legislative scheme that the Class C stock is a capital asset having a long-term value. Its cost is, therefore, not deductible as an interest expense. Pp. 302-312.

431 F. 2d 1320, reversed and remanded.

MARSHALL, J., delivered the opinion of the Court, in which all members joined except BLACKMUN, J., who took no part in the consideration or decision of the case.

Matthew J. Zinn argued the cause for the United States. With him on the briefs were *Solicitor General Griswold*, *Assistant Attorney General Walters*, *Thomas L. Stapleton*, and *Leonard J. Henzke, Jr.*

John C. Satterfield argued the cause for respondents. With him on the brief was *J. Dudley Buford*.

Mac Asbill, Jr., Harold S. Cook, D. Jeff Lance, and William W. Beckett filed a brief for Agway, Inc., et al. as *amici curiae* urging affirmance.

MR. JUSTICE MARSHALL delivered the opinion of the Court.

Mississippi Chemical Corp. and Coastal Chemical Corp. (hereinafter taxpayers) instituted this action for a tax refund in the United States District Court for the Southern District of Mississippi. Both taxpayers are "cooperative associations" within the meaning of § 15 of the Agricultural Marketing Act, 46 Stat. 18, as amended, 12 U. S. C. § 1141j, and thus qualify for membership in one of the 12 "Banks for Cooperatives" (hereinafter Bank(s)) established by the Farm Credit Act of 1933, 48 Stat. 257, as amended, 12 U. S. C. § 1134 *et seq.* Since their principal places of business are located in Mississippi, their regional Bank is the one located in New Orleans.

The Farm Credit Act of 1933 provides that members may borrow money from their Banks and, soon after securing membership in the New Orleans Bank, the taxpayers elected to borrow.¹ Thereafter, they were required by the Farm Credit Act of 1955, 69 Stat. 656, 12 U. S. C. § 1134d (a)(3), which partially amended the 1933 Act, to make quarterly purchases of \$100 par value Class C stock of the Bank equal to not less than 10% nor more than 25% of the amount of the quarterly interest that they paid to the Bank on

¹ Mississippi Chemical Corp. acquired the share of stock qualifying it as a borrower in 1956; Coastal Chemical Corp. acquired its qualifying share in 1957.

their loans. During the period relevant to this lawsuit, the rate set by the Bank was 15%.²

On their tax returns for the years in question, the taxpayers claimed a \$99 interest expense deduction for every \$100 stock purchase required by the statute.³ The Commissioner of Internal Revenue disallowed the deductions, the taxpayers paid the assessed deficiencies, and this action arose.

The United States has consistently contended that the stock that the taxpayers were required to purchase under the 1955 Act is a capital asset as defined by § 1221 of the Internal Revenue Code, 26 U. S. C. § 1221, and that its cost is nondeductible. See 26 U. S. C. § 263. The taxpayers have persistently urged that the money expended for this stock is part of "the amount [they] . . . contracted to pay for the use of borrowed money," *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560 (1932), and is deductible as interest. 26 U. S. C. § 163 (a).

The District Court found for the taxpayers⁴ and the United States Court of Appeals for the Fifth Circuit affirmed over the dissent of Judge Godbold. 431 F. 2d 1320 (1970). We granted certiorari on February 22, 1971, to review the decision of the Court of Appeals. 401 U. S. 908. We reverse for the reasons stated below.

² Mississippi Chemical Corp. challenges the Government's tax treatment of \$55,113.19 spent from 1961 to 1963; Coastal Chemical Corp. challenges the treatment of \$211,799.68 expended from 1958 to 1963.

³ One dollar was treated as the cost of acquiring a capital asset.

⁴ This decision is unreported but is found in App. 342-346. Other lower courts have split on the issue presented. Compare, e. g., *M. F. A. Central Cooperative v. Bookwalter*, 427 F. 2d 1341 (CA8 1970), rev'g 286 F. Supp. 956 (ED Mo. 1968), pet. for cert. pending (No. 70-22); with *Penn Yan Agway Cooperative, Inc. v. United States*, 189 Ct. Cl. 434, 417 F. 2d 1372 (1969).

I

Early in this century, Congress recognized that farmers had a tremendous need for long-term capital at low interest rates. This led to the enactment of the Federal Farm Loan Act of 1916, 39 Stat. 360, as amended, 12 U. S. C. § 641 *et seq.* The immediate purpose of the bill was "to afford those who [were] engaged in farming or who desire[d] to engage in that occupation a vastly greater volume of land credit on more favorable terms and at materially lower and more nearly uniform interest rates than [were] present[ly] available." H. R. Rep. No. 630, 64th Cong., 1st Sess., 2. The long-range purpose was to stimulate and foster a cooperative spirit among farmers who, it was hoped, would work together to seek agricultural improvements which they would finance themselves. *Id.*, at 2-3; S. Rep. No. 144, 64th Cong., 1st Sess., 5.

The 1916 Act divided the United States into 12 regional districts under the general supervision of a Federal Farm Loan Board. Each district contained a federal land bank designed to loan money to farmers at low interest rates. Persons desiring to borrow were required to organize into groups of 10 or more which were called "national farm loan associations." Sec. 7, 39 Stat. 365.

In order to borrow from the district bank, an association had to establish that each of its members was an owner or a prospective owner of a farm, that the loan desired by each member was not less than \$100 nor more than \$10,000, and that the aggregate of the loans was not less than \$20,000. Each association also had to subscribe for capital stock of the bank in the amount of 5% of the total loan sought by its members. The

association, in turn, was required to compel each of its members to purchase stock in the association equal to 5% of the amount of the loan sought by that member. Hence, there were two separate levels of cooperative association.⁵

The legislative history and the language of the Act itself indicate that Congress faced somewhat of a dilemma in structuring the land bank system. On the one hand, there was a strong congressional desire to stimulate a privately controlled, privately owned, and privately financed program based upon the cooperative efforts of dedicated farmers. This desire was effectuated in large measure in the stock-purchase requirements discussed above. On the other hand, Congress realized that without federal help, the existing plight of the farmers would probably render them unable to support the system themselves, and it would thus be doomed to failure:

"The greatest difficulty in the establishment of a rural-credit system, based upon the cooperative principle, is met in connection with the inauguration of the system. Ample capital is absolutely necessary at the start and whatever sums the first borrowers might be able to contribute would in no wise suffice to get the system into successful operation. The system must be endowed, temporarily at least, with capital from sources other than the subscriptions to capital stock among the borrowers."

H. R. Rep. No. 630, 64th Cong., 1st Sess., 9.

Accord, S. Rep. No. 144, 64th Cong., 1st Sess., 4.

⁵ The statute also provided that "joint stock land banks" could be formed. These were corporations, composed of 10 or more persons, who desired to form banks to loan money to farmers without the aid of congressional financing. They were subject to the same restrictions and conditions imposed on the district land banks.

To resolve the dilemma, Congress provided for temporary public financing without charge to supplement the stock-purchase requirements of the statute. Congress also provided that each land bank must periodically increase its capital shares in order to achieve the goal of private ownership of the system, and to repay the temporary federal financing.

The land bank system remained virtually untouched⁶ until the economic depression of the 1930's when Congress determined that more action was needed to aid farmers in establishing privately owned institutions designed to provide ready sources of long-term credit. The Farm Credit Act of 1933 was passed to supplement the 1916 legislation. It established, *inter alia*, regional Banks for Cooperatives in each of the 12 land bank districts and a Central Bank for Cooperatives in Washington, D. C.⁷

These Banks were authorized to make loans to "co-operative associations," defined as "association[s] in which farmers act together in processing, preparing for market, handling, and/or marketing the farm products of persons so engaged, and also . . . association[s] in which farmers act together in purchasing, testing, grading, processing, distributing, and/or furnishing farm supplies and/or farm business services." Agricultural Marketing Act § 15, 46 Stat. 18, as amended, 12 U. S. C. § 1141j.

The new Banks paralleled in many ways those already established under the 1916 legislation. The same re-

⁶ While Congress did not disturb the land bank system, it added to it at various times. For example, Title II of the Agricultural Credits Act of 1923, 42 Stat. 1461, 12 U. S. C. § 1151 *et seq.* (1958 ed.), was designed to aid farmers in obtaining short-term credit.

⁷ The Act also established a production credit system to improve short-term financing for farmers. That system has no bearing on this case.

gional districts were used, many of the same persons were eligible for loans from both institutions, and borrowers from both banks were required to be stockholders. The 1933 Act required cooperative associations to own, at the time a loan was made, an amount of stock in the Bank for Cooperatives equal in fair book value (not to exceed par value) to \$100 per \$2,000 of the amount of the loan, or 5%, the same amount of stock required of borrowers from land banks under the 1916 Act.

One notable difference between the 1916 and the 1933 Acts was that the latter did not regulate the membership of the cooperative association to any great degree. For example, members of cooperative associations did not have to own stock in the associations, only in the Banks; they did not have to borrow a minimum amount; and they did not have to be farm owners or prospective farm owners, but could be processors, handlers, testers, or marketers. This is in sharp contrast to the stringent requirements of the 1916 legislation. Another notable difference is that Congress invested substantially more money in the 1933 program (\$110,000,000) than it had invested in the land banks (\$9,000,000). See S. Rep. No. 1201, 84th Cong., 1st Sess., 5, 7.

As time passed, Congress watched the land bank system develop as planned. The temporary Government capitalization that had solidified the program in its inception was gradually replaced by private capital, and by the end of 1947, the Government's capital had been completely returned. S. Doc. No. 7, 84th Cong., 1st Sess., 4; S. Rep. No. 1201, 84th Cong., 1st Sess., 7. The land banks became totally private concerns—owned, operated, and financed by farmers without Government assistance.

Congress also watched the development of the Banks for Cooperatives and became concerned about their lack

of success in attracting and keeping private investment. By the 1950's, the Government still retained over 88% of the stock in the Banks. In § 2 of the Farm Credit Act of 1953, 67 Stat. 390, 12 U. S. C. § 636a, Congress stated that "[i]t is declared to be the policy of the Congress to encourage and facilitate increased borrower participation in the management, control, and ultimate ownership of the permanent system of agricultural credit made available through institutions operating under the supervision of the Farm Credit Administration" A Federal Farm Credit Board was created for the purpose, *inter alia*, of making recommendations concerning the best way to convert the Banks for Cooperatives from predominantly Government-owned to predominantly privately owned institutions.

The result of the Board's report and recommendations was the Farm Credit Act of 1955, 69 Stat. 655. It sought to effectuate Congress' policy by providing for the orderly withdrawal of Government capital from the Banks and the continual influx and retention of substitute private financing. See S. Doc. No. 7, 84th Cong., 1st Sess., 6; S. Rep. No. 1201, 84th Cong., 1st Sess., 1; Hearings on Farm Credit Act of 1955 before the House Committee on Agriculture, 84th Cong., 1st Sess., 30-31.

II

Under the Farm Credit Act of 1933, there was only one class of capital stock in the Banks for Cooperatives. The Farm Credit Act of 1955 provided for three distinct classes of stock—A, B, and C.

Class A stock may only be held by the Governor of the Farm Credit Association on behalf of the United States. Whatever stock the Government held in the Banks prior to the 1955 Act was converted to Class A stock. This stock is nonvoting and receives no divi-

dends. Class A stock must be retired each year in an amount equal to the amount of Class C stock issued during the year. 12 U. S. C. § 1134d (a)(1). Once the United States' stock is completely redeemed, the Government will invest no more in the Banks, except that it may purchase additional shares of the Class A stock if an emergency makes it necessary in order for the bank to meet the credit needs of eligible borrowers.² See 12 U. S. C. §§ 1134d (a)(1), 1134b, 1134i.

Class B stock represents a new approach to capitalizing the Banks. It is an investment stock available to the public. It pays noncumulative dividends upon certain conditions. Class B stock may be retired only after all Class A stock. 12 U. S. C. § 1134d (a)(2).³

Class C stock may be issued only to farmers' cooperative associations, except that each regional bank is required to purchase such shares from the Central Bank. This stock may be obtained under four circumstances. One share is required to initially qualify any association as a borrower of a regional Bank. Each borrower must then make the quarterly stock purchases which gave rise to this lawsuit. In addition, 12 U. S. C. § 1134l (b) provides that after certain expenditures are made each year, patronage refunds may be allocated to borrowers in the form of Class C stock. "All patronage refunds shall be paid in the proportion that the amount of interest earned on the loans of each

² There is evidence in the record that the Government capital is being revolved out of the Banks just as Congress anticipated. See Farm Credit Administration, *Banks for Cooperatives—A Quarter of a Century of Progress*, excerpted in App. 157, 175. See also 431 F. 2d 1320, 1332, and n. 17 (Godbold, J., dissenting); Brief for the United States 7.

³ The Class B shares are of only nominal importance. In 1963, they amounted to only some 5% of the total outstanding stock of the New Orleans Bank.

borrower bears to the total interest earned on the loans of all borrowers during the fiscal year." *Ibid.*¹⁰ Borrowers also receive at the end of each fiscal year an "allocated surplus" credit which is payable out of the Bank's net savings. Like patronage refunds, allocated surplus is credited to each member in accordance with the proportion that the interest on its loans bears to the interest on all loans. When the surplus account reaches 25% of the total outstanding capital stock of the Bank, the excess may be distributed to members in the form of Class C stock.

Only the tax treatment of the quarterly purchases is disputed here.¹¹ The taxpayers correctly note that the Class C stock has attributes which would make a normal commercial stock undesirable. For example, the C stock pays no dividends;¹² it is transferable

¹⁰ The patronage refunds and the allocated surplus, discussed *infra*, are not a return on the amount of capital that the borrower contributes to the Bank; they are distributions of earnings, not presently convertible to cash, but are eventually convertible just as the quarterly Class C purchases may eventually be redeemed.

¹¹ The Government contended in the District Court that the taxpayers should have reported the patronage dividends as income. The District Court disagreed and the Government did not appeal this point. It is not, therefore, reviewable here, and the Government does not urge that we consider it.

¹² While no formal dividends are paid on the C stock, it is apparent that the patronage dividend is in many ways equivalent to the traditional corporate dividend. As noted above, the patronage dividend is not immediately convertible to cash, but it is far from worthless. Like the usual corporate dividends, the patronage dividends are paid in proportion to stock ownership. Stock ownership is apportioned according to the amount a Bank member borrows. Thus, those who borrow the most own the most stock and receive the most patronage dividends (and surplus as well). As the Class A stock and the earlier issued Class B and Class C stock are redeemed, the C stock issued as dividends will become convertible to cash and its value will be realized at that time.

In the event of a default by a borrower, the Class C stock is

only between cooperatives and only under rare circumstances; additional shares do not provide additional voting power;¹³ and the stock cannot be redeemed until all A, all B issued earlier or in the same year, and all earlier issued C shares have been called for redemption. These characteristics render the market for C shares virtually nonexistent.

It must be remembered, however, that the stock was intentionally given these characteristics by a Congress with definite goals in mind.¹⁴ The legislative history of the Farm Credit Act of 1955 indicates that Congress placed much of the blame for the Bank's inability to

set off against the amount of the loan. Hence, the more patronage dividends the member receives, the more security he has in case of default.

¹³ Cooperative associations are entitled to vote in polls designating nominees for appointment to the Federal Farm Credit Board, established by the Farm Credit Act of 1953, 67 Stat. 390, as amended, 12 U. S. C. § 636c, to help effectuate congressional policy; to vote in the nomination polls and elections of members of district farm credit boards established by the Farm Credit Act of 1937, 50 Stat. 703, 12 U. S. C. § 640a; and to vote in the nomination and elections of directors of the Central Bank for Cooperatives. It is normal for every member of a cooperative to have only one vote, irrespective of a disparity between the shares held. See *Frost v. Corporation Comm'n*, 278 U. S. 515, 536-537 (1929) (Brandeis, J., dissenting); I. Packel, *The Law of Cooperatives* §§ 23-24 (a), pp. 136-140 (3d ed. 1956). It is interesting that the Capper-Volstead Act, 42 Stat. 388, 7 U. S. C. §§ 291-292, permits a cooperative marketing association immunity from the Sherman Act under some circumstances, but *only* if no member is entitled to more than one vote.

¹⁴ Cooperatives and corporations operate on different principles. Whereas the corporate structure separates control and management, the essence of a cooperative requires that these functions be integrated. And, whereas the value of corporate stock depends on ease of transferability (or marketability), the value of cooperative stock lies in the durable, long-term nature of the investment. See Nieman, *Revolving Capital in Stock Cooperative Corporations*, 13 *Law & Contemp. Prob.* 393 (1948).

repay the capital extended by the Government and to retain private capital on the provision in the 1933 legislation which permitted borrowers to redeem their stock for cash upon paying off their loans. The restrictions on redemption and transferability and the dividend prohibition were designed to obviate this difficulty and to provide both a stable membership and permanent capital, two necessities for the success of any cooperative venture.

III

The taxpayers do not seek to deduct the cost of their initial shares in the Bank as interest. They accept the fact that these shares represent one cost of membership and that this cost is a capital expense because membership is a valuable asset in more than one taxable year. But, they argue that once they purchased their initial shares, they obtained full membership rights, and, *a fortiori*, that Congress must have intended the quarterly expenditures for stock to be a charge for borrowing money since the stock has no value. The fact is, however, that the stock purchased quarterly is indeed valuable. The amounts paid for C shares become part of the permanent capital structure of the Bank, thereby increasing the stability of the Bank and insuring its continued ability to extend credit. Each share also provides an opportunity for more patronage and surplus dividends, an ultimate right of redemption, and an asset that may be used as a set-off in case of a default on the loan. In sum, every share of stock purchased quarterly by the taxpayers is nearly as valuable as the shares purchased initially. It is therefore difficult to understand why these different purchases should receive radically different tax treatment. If Congress had required 1,000 or 100,000 shares of Class C stock to be pur-

chased before an association could borrow from the Banks, under the taxpayers' theory of the case the cost of those shares would be a nondeductible capital expense. Simply because Congress eased the burden on farmers by spreading the requirement of capital investment over a period of time rather than requiring it as a prerequisite to borrowing, the taxpayers are entitled to no more favorable tax treatment.

It is important not to lose sight of the congressional purposes in enacting the farm credit legislation. The immediate goal was to provide loans to farmers at low interest rates. It would, therefore, be odd for Congress to provide a "hidden" interest charge in the legislation. The long-range goal was to make the Banks "fully cooperative and to place full ownership and responsibility for their operations and success in the hands of those eligible to borrow from them." Hearings on Farm Credit Act of 1955 before a Subcommittee of the Senate Committee on Agriculture and Forestry, 84th Cong., 1st Sess., 60. Congress felt, in light of its experience under the Farm Credit Act of 1933, that the long-range goal could only be achieved if Bank members made long-term investments in the Banks. Hence, Congress created Class C stock, a security with a special value in cooperative ventures. While this security is *sui generis*, the congressional scheme makes it clear that it has value over the long run.

Since the security is of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code, and its cost is nondeductible. Cf. *Commissioner v. Lincoln Savings & Loan Assn.*, 403 U. S. 345 (1971); *Old Colony R. Co. v. United States*, 284 U. S. 552 (1932); 26 CFR § 1.461-1.

We reject the contention that while the Class C

stock may be a capital asset, it is worth only \$1,¹⁵ and that the additional \$99 paid for each share must represent interest. Were we dealing with the traditional corporate structure in this case, the taxpayers' argument would have strength. But, as we have pointed out previously, the essential nature of cooperatives and corporations differs. The value of the Class C stock derives primarily from attributes other than marketability. The stock has value because it is the foundation of the cooperative scheme; it insures stability and continuity. The stock also has value because it enables the farmers to work together toward common goals. It enables them to share in a venture of common concerns and to reap the rewards of knowing that they can finance themselves without the assistance of the Federal Government. It is perhaps debatable whether these attributes should properly be valued at \$100 per share, but we are not called upon merely to resolve a question of valuation. Rather, we must decide whether it is artificial to characterize these unique expenditures as payments for a capital asset. We find that it is not.

The taxpayers and the Government each allege that the other is looking at form rather than substance. At some point, however, the form in which a transaction is cast must have considerable impact. *Guterman, Substance v. Form in the Taxation of Personal and Business Transactions*, N. Y. U. 20th Inst. on Fed. Tax. 951 (1962).

¹⁵ It is by no means clear that the Class C stock is worth only \$1 even under a traditional market value analysis. The lower courts failed to include the value of the patronage and surplus dividends in computing the value of the quarterly purchases. The Class C stock may, therefore, be worth considerably more than \$1, although the Government concedes that it is not worth \$100. Because of the result we reach in this case, we have no occasion to make a final determination as to what value the stock would have under a market value analysis.

Congress chose to make the taxpayers buy stock; Congress determined that the stock was worth \$100 a share; and this stock was endowed with a long-term value. While Congress may have been able to achieve the same ends through additional interest payments, it chose the form of stock purchases. This form assures long-term commitment and has bearing on the tax consequences of the purchases.

Accordingly, the decision of the Court of Appeals is reversed and the case is remanded with direction that judgment be entered for the United States.

It is so ordered.

MR. JUSTICE BLACKMUN took no part in the consideration or decision of this case.